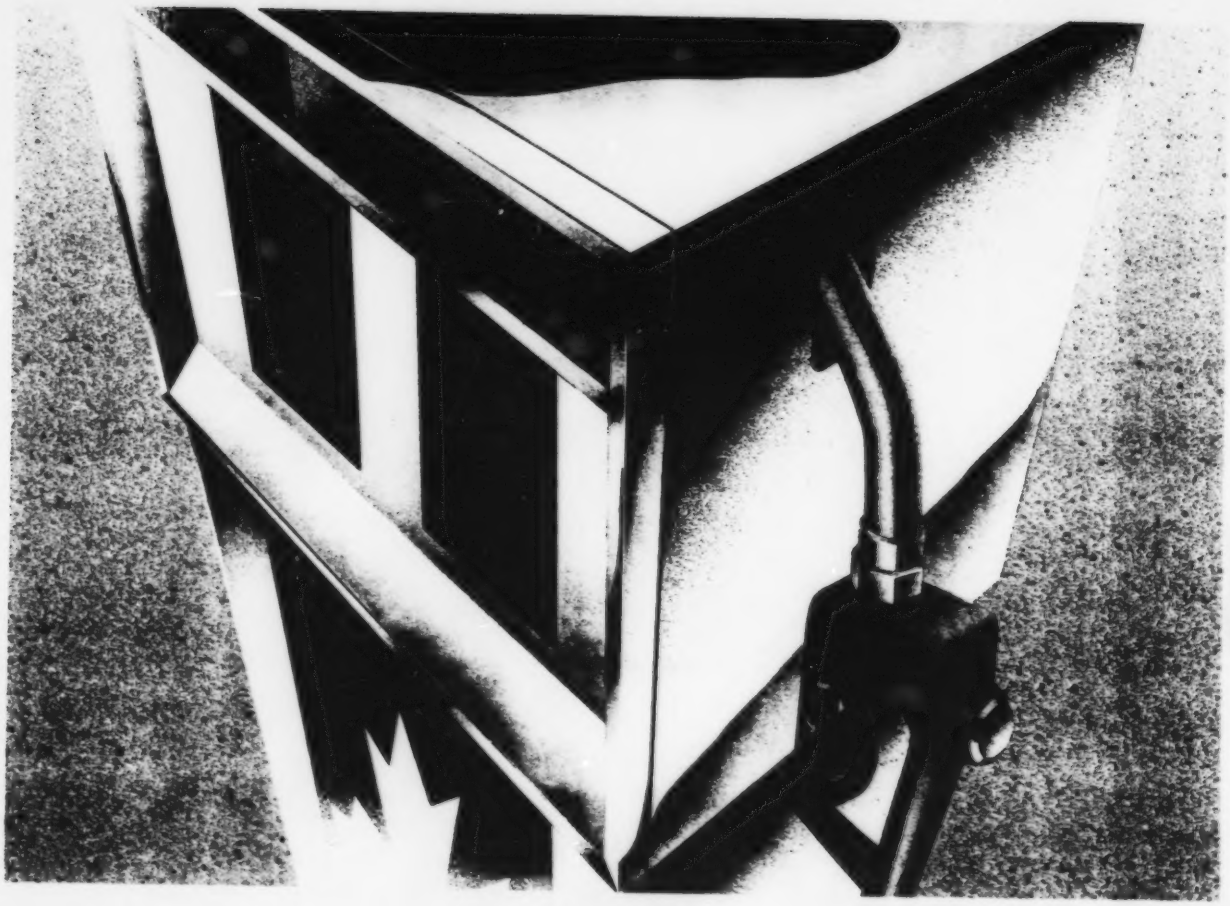
Petro-Canada



1986

Annual

Report

92-05269/

Corporate Profile

Petro-Canada, formed by an Act of Parliament in 1975, is wholly owned by the Government of Canada. Operations began on January 1, 1976. The Corporation is primarily engaged in oil and gas exploration and production, and the transportation, refining and marketing of hydrocarbons for Canadian needs.

Petro-Canada is the largest Canadian-owned company in the petroleum industry and the only Canadian-owned oil and gas company with a national marketing network. With assets in excess of $8 billion, the Corporation ranks among the top five companies in all commonly used operating measures in exploration and production, and is one of the nation's largest refiners and marketers of petroleum products.

Contents

1 Financial and Operating Highlights

2 Chairman's Message

5 The Refining and Marketing Business – Prices, Profits and Reinvestment

9 Discussion of Results

12 Resources Division Highlights

18 Products Division Highlights

24 Corporate Responsibility

25 Financial Statements

31 Notes to Financial Statements

43 Five Year Summaries

46 Directors and Senior Officers

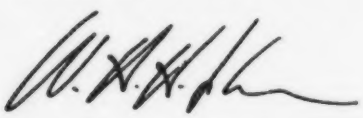
March 23, 1987

The Honourable Marcel Masse, P.C., M.P.
Minister
Energy, Mines and Resources Canada
House of Commons
Ottawa, Ontario

Dear Minister:
On behalf of the Board of Directors, I am pleased to present Petro-Canada's Annual Report for the fiscal year ended December 31, 1986.

In accordance with the provisions of the Financial Administration Act, the Report includes the consolidated financial statements together with the auditors' report thereon.

Yours sincerely,



W.H. Hopper
Chairman of the Board
and Chief Executive Officer

Consolidated Financial and Operating Highlights

Financial	1986	1985
Earnings after dividends on redeemable preferred shares (millions of dollars)	123	96*
Internally generated cash from operations (millions of dollars)	770	906
Capital expenditures (millions of dollars)		
Property, plant and equipment, net of incentives	448	710
Acquisitions including minority interests	301	1010

*before unusual items

Operating	1986	1985
Crude oil and field natural gas liquids production, net before royalties (thousands of m^3 per day)	16.3	15.7
Natural gas production, net before royalties (millions of m^3 per day)	10.2	11.6
Natural gas liquids production from straddle plants (thousands of m^3 per day)	2.6	2.6
Crude oil processed by Petro-Canada (thousands of m^3 per day)	47.2	34.2
Petroleum product sales (thousands of m^3 per day)	44.3	35.5

Chairman's Message

The past year was a time of crisis for the world's oil industry, and Canadian companies were no exception. In 1986, average crude oil prices were approximately 45 per cent below 1985 levels; small increases towards year end were encouraging but prices remained volatile. Few industries, particularly of the magnitude of Canada's oil and gas business, have had to adapt to such a drastic cut in the price of their primary product.

The price slide severely tested Petro-Canada's financial health and its entrepreneurial spirit, making it the most critical year yet for the Corporation. However, I am pleased to report that 1986 was a year in which good ideas became creative solutions, and the Corporation was sufficiently strong and diversified to weather the storm.

The past year was a time of crisis for the world's oil industry.

Petro-Canada's performance in this exceptionally difficult year signals the successful transition from a policy-guided to a commercially driven company. While in the past Petro-Canada was directed to invest aggressively in Canada's frontier areas, its activities and expenditures are now geared to enhancing the Corporation's already substantial financial health and operating capability. This has required a greater focus on short-term cash generation, as well as a continued position in the most promising energy development projects, thereby providing the potential for dynamic growth in the future.

Petro-Canada was sufficiently strong and diversified to weather the storm.

During 1986, Petro-Canada, in common with the rest of the industry, was forced to re-evaluate all of its operations in light of the new business environment. The need to concentrate on short-term cash generation meant that tough decisions had to be made quickly, with the primary emphasis on developing cost savings and efficiencies to improve margins. In the upstream division, costs were reduced through a concerted re-examination of all oilfield operations and procedures. In the downstream, marketing facilities were rationalized, making assets more productive. Realignment and centralization reduced staff levels in all divisions in order to further cut costs and improve productivity. While many of these measures were difficult to implement, and only possible through the hard work and understanding of Petro-Canada's staff, the Corporation has gained fundamental efficiencies that will have enduring benefit.

Petro-Canada's emphasis on its immediate financial strength has not precluded attention to the Corporation's long-term needs. We are continuing our activity in

Canada's offshore and oil sands areas, albeit at a reduced level, and will participate in the development of these substantial reserves when they become commercially feasible. Petro-Canada expects oil prices to remain volatile in the foreseeable future, so that financial risks will continue to be high for new frontier projects. As a result, it is likely that Canadian consumers will rely increasingly on imported oil over the coming years. This is a fundamental issue facing Canada. It is up to governments to decide whether they will provide the financial assistance necessary for industry to develop higher-cost domestic reserves and displace at least some of these imports, thereby lessening Canada's vulnerability to interruptions or rising costs of imported supply.

Specific financial results for 1986 were encouraging despite the difficult economic climate. Earnings were $123 million. Internally generated cash from operations was healthy at $770 million and sufficient to carry out an appropriate level of activity for current opportunities, as well as to keep debt manageable. When it becomes feasible for Petro-Canada to participate in major new frontier and oil sands developments, the Corporation will require considerable additional external financing in a judicious mix of debt and equity.

The Corporation has gained fundamental efficiencies that will have enduring benefit.

The year's results reflect the strengthening of Petro-Canada's downstream division over the last few years. The acquisition and integration of downstream operations from BP Canada Inc. in 1983 and Gulf Canada Limited in 1985 and 1986

have enabled us to develop a large and competitive petroleum products business, with significant refining and marketing operations from coast to coast. The contribution from downstream operations improved in the second half of 1986, as it did for our competitors, but profitability and returns on investment remain modest. However, this improvement was significant for the Corporation, allowing it to maintain a satisfactory level of investment despite the world oil price slide and the consequent reduction in upstream cash flow.

Financial results for 1986 were encouraging despite the difficult economic climate.

Operating highlights in 1986 included the addition of the modern, efficient Edmonton refinery and the integration of the other former Gulf operations within a carefully considered strategy to optimize returns. In the upstream, exploration was increasingly focused on Western Canada conventional fields, and production was held at historically high levels despite cuts in operating expenses.

Petro-Canada sees its strong commercial performance as consistent with a commitment to Canadians. We are here to serve Canada's energy interests, and are dedicated to the development of Canadian projects in a manner that is financially sound and beneficial to Canada. In the downstream, our marketing programs involve the Corporation in the activities and initiatives of people in every region of the country. Petro-Canada continues to press forward in providing opportunities to all Canadians through the implementation of its Official Languages Program and active measures to promote employment equity. As the largest Canadian-owned energy company, Petro-Canada is a leader in sports and safety programs for youth, and supports education, the arts and cultural activities. The Corporation is particularly proud to ask all Canadians to share in carrying the Olympic torch across Canada for the 1988 Winter Games.

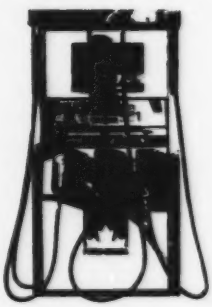
W.H. Hopper
Chairman of the Board
and Chief Executive Officer

March 23, 1987

Prices, Profits and Reinvestment

In Petro-Canada's 1985 Annual Report, Chairman of the Board W.H. Hopper discussed the factors holding down profitability in the Canadian refining and marketing industry. He expressed concern that returns on investment in the "downstream" refining and marketing sector were too low to sustain the continued investment required to maintain services to the Canadian public.

To put things into perspective, an understanding is needed of the structural changes that have challenged and transformed the downstream industry over the past 15 years. These changes continue today, and refining and marketing companies must continue to respond if they are to survive as effective businesses.



Reasonable financial returns are needed so that investments to modernize facilities can continue.

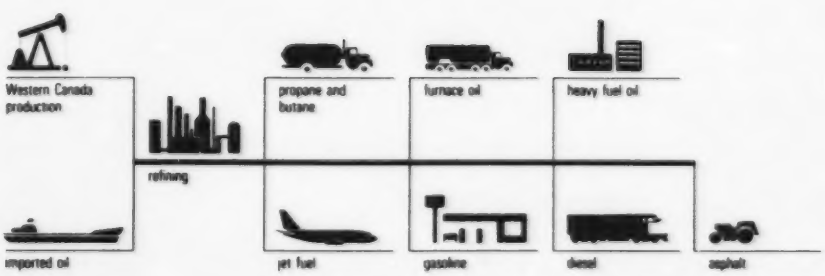
Consumer demand has changed

The price shocks in world crude oil markets of 1973-74 and 1978-79, and the more gradual price increases in between, transformed Canadians' use of energy in general and oil products in particular. Conservation efforts, such as improved home insulation and smaller cars with more fuel-efficient engines, as well as the switch to such alternative fuels as electricity and natural gas, led to an unprecedented drop in demand for petroleum products. From its peak in 1979, total domestic Canadian demand for petroleum products declined almost 25 per cent by the end of 1985. The trend to lower demand accelerated as prices peaked in the early 1980s; it had so much momentum that overall product demand continued to fall in 1986 despite the sharp drop in product prices.

Declining volume was not the only challenge facing refiners in recent years. Changes in the mix of products required by consumers pushed refineries to their limits and forced capital investments to upgrade and modify them. That trend continues, with market patterns and environmental concerns both driving technological change.

Increasingly, the market is demanding more light transportation fuels and less heavy product from each barrel of oil. In 1979, gasoline, diesel, jet fuel and petrochemical feedstocks made up 60 per cent of the overall product mix. By 1986 these light products accounted for 72 per cent of production.

Using domestic and imported crude oil, Canadian refineries produce a variety of products for industrial and consumer use.



Product pricing

The more than 60 per cent drop in world crude oil prices in early 1986 created expectations among some consumers of a similar drop in retail prices for gasoline and other products.

While understandable, such expectations were not realistic. The cost of crude oil is only one of several factors which affect the final consumer price. Other costs include transportation by tanker or pipeline from wellhead to refinery, refinery processing, distribution from refinery to retail outlets, a margin for the dealer, and federal and provincial taxes levied at the pump. Most of these cost elements remain unchanged or have even increased. Looking at 1986 gasoline prices in Toronto, for example, the price for regular leaded gasoline declined 11.2 cents over the course of the year, reflecting the 12.2 cents per litre decline in crude. Both total taxes levied at the pump and the dealer margin remained relatively unchanged. The net effect was a small improvement in the amount remaining to cover the costs of refining, distributing and marketing finished products and to provide only a modest return on investment.

In response to competitive pressure, retail prices fell substantially in 1986. It should be appreciated, though, that the downstream sector has struggled through a difficult period of contraction and adjustment with very poor returns on capital employed. Some turnaround is needed to enable the industry to make the investments required in the years to come. Continued gains in efficiency and improved marketing returns will be needed to effect that turnaround.

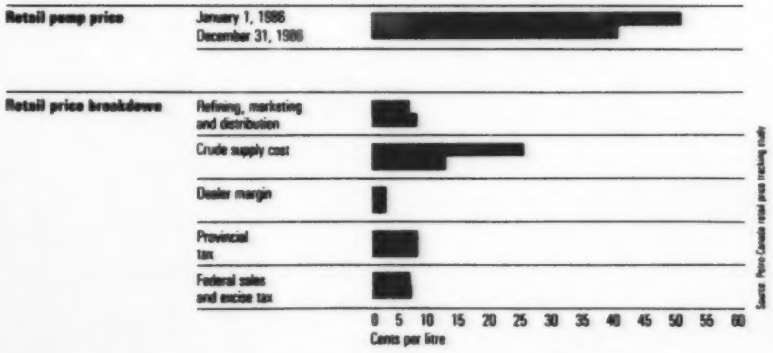
High, ongoing investments required

The decline in product demand has forced the downstream business to contract. The refining sector was particularly hard hit as refinery utilization rates plummeted. Because they have high, fixed capital and operating costs, refineries must maintain high utilization rates to operate economically. Surplus refining capacity across Canada caused 11 refineries, representing 17 per cent of industry capacity, to close between 1979 and 1986. Even so, average utilization has dropped from 87 per cent to 80 per cent. More refineries could be closed if this situation persists.

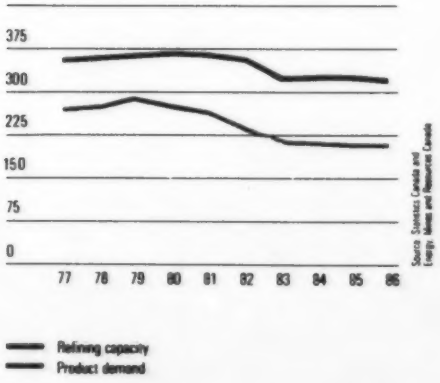
Meanwhile, refiners had to invest heavily in new processing equipment to keep up with market trends and new environmental safeguards. Older refineries, built for the product mix and crude supply of days past, had difficulty keeping up, and these were often the first to close. On the other hand, a few refiners expanded their facilities or built new plants with the latest technology, giving them some advantage in meeting product demand but adding to the general problem of overcapacity.

The fight to retain sales volume in a shrinking market has led to sustained price competition over the past few years in both wholesale and retail marketing, to the benefit of the consumer but at a cost to the financial health of the industry.

A price comparison for regular gasoline sold at self-serve stations in Toronto shows the drop in pump price was roughly equivalent to the lower crude supply cost, while other cost components stayed about the same.


Retail pump price
January 1, 1986
December 31, 1986
Retail price breakdown
Refining, marketing and distribution
Crude supply cost
Dealer margin
Provincial tax
Federal sales and excise tax
0 5 10 15 20 25 30 35 40 45 50 55 60
Cents per litre
Source: Petro-Canada retail price tracking study

Declining product demand forced refinery closures but excess capacity remains.
(thousands of cubic metres per calendar day)



Frequent protracted price wars have been a symptom of the imbalance between supply and demand. To remain competitive, marketers have continued to invest in upgrading their retail networks. Nevertheless, declining sales volumes and low margins made more and more outlets uneconomic. All companies had to rationalize their networks, selling or closing unprofitable outlets and finding ways to cut costs, boost efficiency and provide more competitive prices. These efforts resulted in the closure of approximately one quarter of all retail outlets between 1979 and 1986. Meanwhile, low wholesale prices allowed independent marketers, with no refining operations to support, to take a significant share of the retail market.

In addition, the deregulation of crude oil and refined product markets has exposed the Canadian industry to international pricing. While this policy of open access helps to maintain a high level of competition, it also reinforces the need for refineries to become more efficient.

In short, recent years have been characterized by sharply lower product demand, low refinery utilization and intense marketing competition at a time when refiners and marketers have had to make substantial investments in their operations.

Profitability has been inadequate

These dramatic changes have had a tremendous impact on the industry's financial performance. Data published by the Federal Government's Petroleum Monitoring Agency show just how extreme that impact has been.

In spite of rising crude oil prices within Canada between 1980 and 1985, downstream revenues showed virtually no growth, reflecting the dramatic slump in demand. Net income and internal cash flow declined sharply, with a consequent decline in downstream capital investment.

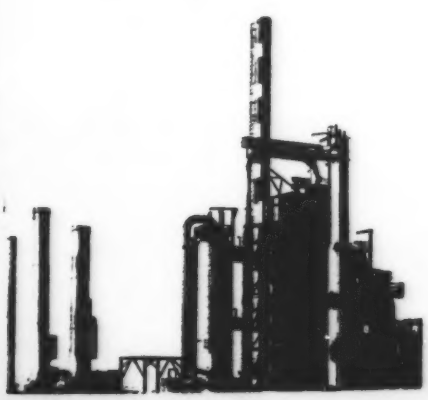
The return on capital employed in the downstream petroleum industry has been consistently lower than returns in manufacturing, regulated energy utilities and most other industries. The average downstream rate of return from 1981 to mid-1986 was only 3.5 per cent, well below rates of return needed to raise new capital for continued reinvestment in this or any other industry. Estimates for year-end 1986 show an improving but still inadequate picture.

Despite these weak financial results, many consumers continue to believe that product prices are unnecessarily high, and that they are kept high by some form of collusion among the major companies. The reality is that intense competition for the remaining market has forced prices down, to the benefit of the consumer. Exhaustive investigations, such as the five-year Restrictive Trade Practices Commission inquiry, have found no evidence of collusion or overcharging. The meagre returns the industry has experienced clearly support the conclusion that the consumer has been well served by a competitive market for petroleum products.

However, this poor financial performance bodes poorly for the future effectiveness of the downstream industry. The downstream is highly capital intensive, with nearly $12 billion of capital currently employed in the business. Moreover, ongoing capital investments in the order of $1 billion annually are required to meet changing consumer needs. The downstream is one of Canada's largest industries, with sales of $34 billion in 1985. It is also a major employer, supporting over 120 000 jobs directly and many more thousands indirectly.

Canada's integrated oil companies must now look more to the downstream to provide cash flow to sustain exploration and development, or Canadians may soon face depletion of existing oil and gas reserves and future shortfalls of supply. Improvement in downstream profitability to levels comparable with those in other industries is essential in coping with the severe effects of lower crude prices.

Refiners have to invest heavily in costly processing equipment to meet new environmental safeguards and keep up with changing consumer requirements.

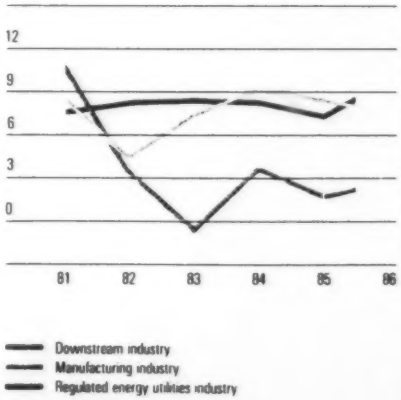


The financial performance of Canada's downstream industry has been unsatisfactory.

(billions of dollars)	1981	1982	1983	1984	1985	1986 First Half
Revenues	33.8	35.1	33.8	31.9	34.0	14.2
Net income	1.3	0.4	(0.1)	0.4	0.2	0.3
Capital employed	11.1	11.4	12.1	12.9	13.6	11.8
Internal cash flow	2.0	1.2	0.8	1.1	1.1	0.5
Capital expenditures	2.0	2.5	1.7	1.1	0.9	0.3

Source: Petroleum Monitoring Agency

The return on capital employed for the downstream industry compares poorly with other industries. (per cent return on capital employed)



Source: Penn Canada calculations based on published data from Petroleum Monitoring Agency and Statistics Canada

Petro-Canada in the downstream

Petro-Canada is a major participant in the Canadian refining and marketing industry, with 21 per cent of the nation's refining capacity and 23 per cent of the gasoline and distillate market.

Since entering the downstream, Petro-Canada has responded dynamically to the challenges of the business, streamlining operations, targeting marketing programs to take advantage of company strengths, and achieving greater efficiency. It seeks to remain in the forefront of innovation, adapting to changing conditions in both refining and marketing. Petro-Canada is committed to maintaining high standards in safety and environmental protection. With its Canadian perspective, it plans to take the lead in meeting the needs of the Canadian public.

Within Petro-Canada, downstream operations have a dual role. They provide petroleum products and services to the public. But they also serve as a channel through which Canadians can support the development of their country's energy resources. The slogan "Pump your money back into Canada" struck a very responsive chord among the Canadian public.

From the beginning of Petro-Canada's marketing activities, the expectation was that cash flow from product sales would help to finance the development of energy supplies for Canada's future.

With the sudden drop in cash flow from crude oil and natural gas, it is more important than ever that the downstream make that kind of contribution to ongoing energy development. Yet in recent years the return on investment in the downstream has been so meagre that it has not even covered downstream reinvestment needs.

Product prices in Canada follow competitive action in a vigorous market. Petro-Canada operates in that market on the same basis as other companies, striving for a reasonable return on investment that is adequate to sustain a vibrant business.

Financial performance must improve

Most of the trends outlined here will continue into the 1990s. Lower prices and economic recovery in much of Canada have slowed the decline in product demand, but it is expected that there will be no growth, or possibly a continued decline, over the next decade. Transportation fuels will increasingly dominate product demand, and refiners will have to invest more in upgrading their refineries. Refiners and marketers must also take further steps in environmental protection to respond to public concern and new legislation. The result will be cleaner, safer operations, but substantial capital expenditures will be required to achieve these benefits. For instance, recent environmental legislation requiring the removal of lead from gasoline, and the upgrading of underground storage tanks, will necessitate investments in the order of a billion dollars.

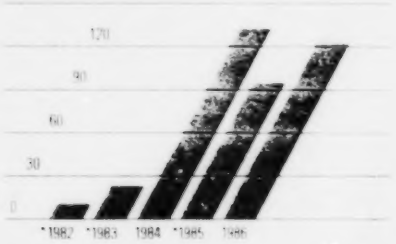
Vigorous competition among marketers will continue. Rival companies will have to rationalize marketing networks further to remain competitive. New services and new products will be needed to gain competitive advantage.

Improved financial performance is clearly necessary. Adequate returns are needed to meet future investment requirements. They are needed to ensure the long-term survival of a downstream industry that is able to offer the range of services and quality of products that Canadians expect. They are also essential to provide ongoing employment and business opportunities, directly and indirectly, to hundreds of thousands of Canadians.

Additional copies of this article can be obtained from
Petro-Canada, Public Affairs
P.O. Box 2844
Calgary, Alberta
Canada T2P 3E3

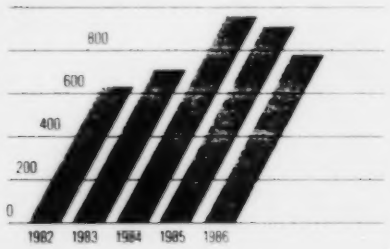
Discussion of Results

Earnings after dividends on redeemable preferred shares (millions of dollars)



*before extraordinary and unusual items

Internally generated cash from operations (millions of dollars)



Swift reaction to world oil price changes

Petro-Canada's financial and operating results for 1986 were driven by the dramatic fall in crude oil prices. In November of 1985, international crude oil prices were about U.S. $31 (Cdn. $42) per barrel; by March 1986, they had dropped to nearly U.S. $10 (Cdn. $14). During the remainder of the year, the price fluctuated between U.S. $11 and $18 (Cdn. $15 and $25). Negotiations within OPEC produced a series of tenuous agreements that limited further price drops and at times held hope for some price recovery. The overall result for Canada's oil and gas industry was that both the value of hydrocarbons produced and the value of reserves remaining in the ground fell substantially.

Petro-Canada quickly recognized that the price drop was not an aberration that would soon reverse itself, but a fundamental reaction to an imbalance between supply and demand. In January 1986, Petro-Canada began a complete review of objectives, strategies and planned activities. Rather than counting on future price increases for relief, the Corporation assumed a low and unstable crude oil price environment. Among the strategies pursued by the Corporation were making the most of existing assets, cutting costs wherever possible, downsizing the organization and keeping it flexible, and selectively investing for short-term cash flow. The Corporation's results for the year indicate that the crisis was successfully managed.

Operating results held firm

Petro-Canada's upstream production results were not markedly different from those of 1985. Production of conventional crude rose slightly as earlier investments came on stream and production efficiencies were improved. The Syncrude plant operated reliably throughout the year and production of synthetic crude reached a record level. Natural gas production was below 1985 levels due to lower demand in the United States for Canadian gas. Production of field natural gas liquids increased substantially as production from new facilities more than offset the impact of lower gas sales.

In the downstream, increased volumes of crude oil processed at the Corporation's refineries as well as higher petroleum product sales resulted from the Gulf acquisition and Petro-Canada's strong presence in every product and market segment.

Financial results encouraging in an exceptionally difficult year

Consolidated earnings (before unusual items and after redeemable preferred share dividends) were $123 million in 1986, up 28 per cent from $96 million in 1985. Reflecting the drop in crude oil prices, Resources Division earnings declined from $197 million in 1985 to $57 million in 1986. Products Division earnings climbed from a loss of $22 million to earnings of $115 million.

The Corporation's results were significantly better than those anticipated earlier in the year. This improved performance was largely a result of management's actions in reducing costs, as well as increases in downstream margins in the second half of the year. Financial results were also greatly assisted by the Gulf acquisition and the carefully implemented integration of the two organizations.

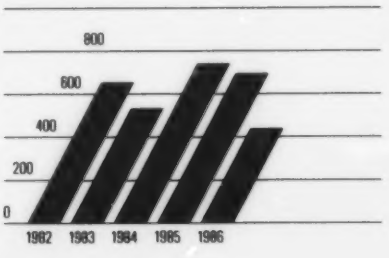
Effective January 1, 1986, the Corporation modified prospectively its full cost method of accounting in accordance with the Canadian Institute of Chartered Accountants' (CICA) Accounting Guideline "Full Cost Accounting in the Oil and Gas Industry". The purpose of the Guideline is to narrow the range of acceptable alternatives which are currently practiced in the application of the full cost method of accounting. A key issue is the maximum amount of costs which may be capitalized (the "ceiling test"). In conducting the ceiling test at December 31, 1986, the Corporation followed the CICA's prescribed method which applies year-end prices and costs to oil and gas reserves and makes provision for financing costs, administrative overhead and income taxes. The Corporation met the ceiling test by a substantial margin.

Internally generated cash from operations (after redeemable preferred share dividends) of $711 million in 1986 was down 14 per cent from $828 million a year earlier. Cash generated by the Resources Division decreased from $847 million in 1985 to $399 million. Cash contributions from the Products Division increased from $71 million in 1985 to $346 million in 1986.

Capital employed by the Corporation at year-end 1986 amounted to $7 105 million, compared to $6 783 million a year earlier. Cash flow return on capital employed declined from 12.2 per cent in 1985 to 11.1 per cent in 1986.

Early in the year, Petro-Canada moved decisively to downsize and streamline the Corporation. Cost-cutting measures and further efficiency gains were

Capital expenditures on property, plant and equipment net of petroleum incentive program grants* (millions of dollars)



*excludes acquisitions

sought in every department. The total staff complement was reduced by 23 per cent after adjustment for the addition of Edmonton refinery personnel in April. Divisional reorganizations were undertaken to ensure that available staff were effectively assigned to priority functions. Some centralization was deemed necessary and several groups of employees were relocated.

Investment activities tailored to new business environment

Capital commitments were cut back in 1986, with emphasis placed on selectively investing for short-term cash flow while at the same time maintaining interests in the more promising longer-term development projects. In particular, investments in the Corporation's exploration program were reduced and the focus was shifted from the frontiers to conventional oil and gas properties in Western Canada. Capital expenditures in the refining and marketing business were also limited to the extent possible during integration of the former Gulf operations.

Capital expenditures on property, plant and equipment after deducting incentives decreased 37 per cent from $710 million in 1985 to $448 million in 1986. Approximately $72 million of the Corporation's capital spending was allocated to exploration for conventional oil and gas in Western Canada, $57 million to frontier exploration, $179 million for production operations, and $111 million for refining and marketing. An additional $301 million was invested in purchasing the assets and related working capital of the former Gulf Canada Limited refinery in Edmonton. The purchase, which was provided for under the terms of the 1985 acquisition agreement, took effect on April 1, 1986. It provides Petro-Canada with one of the largest, most modern and efficient refineries in the country. In addition, it increases the Corporation's refining capacity in Western Canada, where market share for petroleum products rose substantially as a result of the 1985 Gulf acquisition.

Financial structure improved

In May, the Corporation completed the issue of U.S. $200 million ten-year 7¼% debentures on the Eurobond market. In December, the Corporation issued U.S. $200 million of thirty-year 8¼% debentures in the United States. The proceeds from these debentures, totalling Cdn. $556 million, were used in part to reduce short-term indebtedness and refund other floating rate indebtedness.

Dividends of $59 million paid on redeemable preferred shares in 1986 were lower than in 1985 due to lower interest rates and share redemptions. A decline in operating working capital of $406 million was brought about by falling crude oil prices, which lowered the investment in crude oil and petroleum product inventories and in accounts receivable.

The Corporation's interest coverage ratio for 1986 was 6.3. In addition, internally generated cash from operations of $770 million was more than sufficient to fulfil Petro-Canada's fixed financial obligations, including both debt and the scheduled redemption of term preferred shares. Overall, financial ratios compared well with those at the end of 1985, demonstrating the Corporation's quick response to changing conditions so as to maintain the integrity of its financial structure.

While Petro-Canada's financial position remains fundamentally sound, it would be imprudent to rely exclusively on debt for any substantial new capital requirements arising from major expansion of the Corporation's activities. Considerable additional external financing will be required if the Corporation proceeds with major new development projects.

Resources Division Highlights

Financial and operating profile

Financial	1986	1985
Revenue (millions of dollars)	1 080	1 636
Earnings (millions of dollars)	57	197
Average capital employed (millions of dollars)	4 104	4 642
Cash flow return on average capital employed (per cent)	10.0	18.1
Capital expenditures (millions of dollars)	319	520

Operating	1986	1985
Crude oil and field natural gas liquids production, net before royalties (thousands of m^3 per day)		
Conventional crude oil	10.7	10.4
Synthetic crude oil	3.5	3.5
Field natural gas liquids	2.1	1.8
Natural gas production, net before royalties (millions of m^3 per day)	10.2	11.6
Natural gas liquids production from straddle plants (thousands of m^3 per day)	2.6	2.6
Proven reserves of crude oil and natural gas liquids, net before royalties (millions of m^3)	88.6	92.3
Proven reserves of natural gas, net before royalties (billions of m^3)	96.7	98.8

The Resources Division results reflect the effectiveness of Petro-Canada's response to the collapse of world oil prices and weak natural gas export markets. Production margins were maximized by reducing operating costs while increasing production rates of crude oil and natural gas liquids. Restructuring eliminated one or more levels of supervision and merged some departments, resulting in a smaller, more focused organization that is appropriate to meet the new business environment. In addition, capital investments were reduced and increasingly directed towards field improvements that would immediately generate cash flow.

Production of crude oil and field natural gas liquids was 16 300 cubic metres per day in 1986, up 4 per cent from 1985. Because of lower demand, daily production of natural gas dropped 12 per cent to 10.2 million cubic metres. During the year, 250 000 cubic metres of crude oil and natural gas liquids and 591 million cubic metres of natural gas were added to the Corporation's reserves base, before production.

Despite sharply reduced revenues from production, the Resources Division was able to provide earnings of $57 million in 1986. Cash contributions reached $399 million. Cash flow return on average capital employed was 10.0 per cent in 1986.

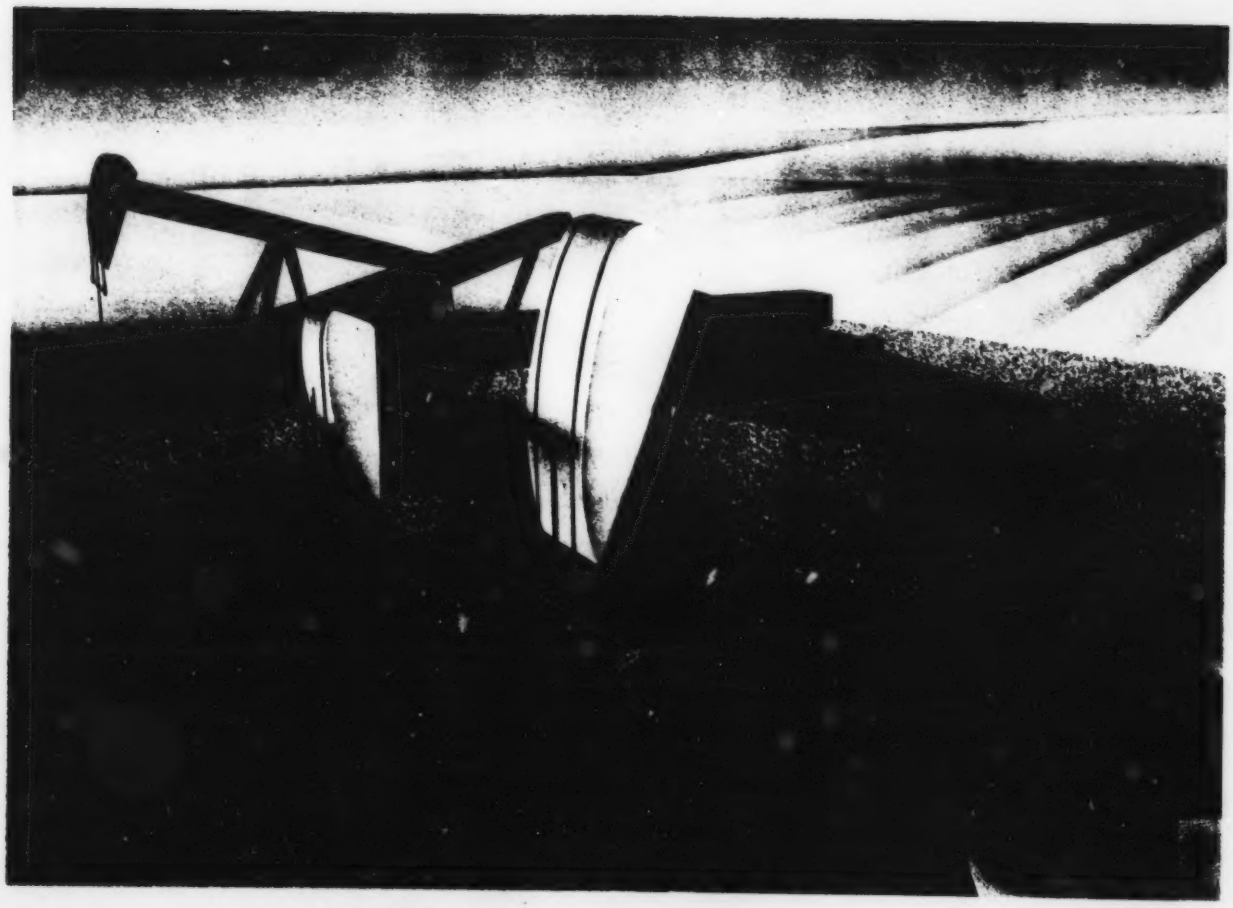
Production returns optimized

Operating costs for company-operated conventional fields were reduced from 1985 levels. This was achieved as a result of an intensive review of all Petro-Canada operated producing properties as well as careful attention to detail at the field level.

While heavy emphasis was placed on cost reduction, an equal effort was made to maintain production. Well workovers were conducted more selectively and plant turnaround work was planned with greater emphasis on minimizing costs and downtime. Product recovery increased at a number of natural gas processing plants following a careful study of process operating conditions and potential efficiencies.

Productivity improvements at the Utikuma Lake oilfield illustrate the gains made through the focus on efficiency in 1986. Though the field is relatively mature, a variety of technical, operational, marketing and management innovations

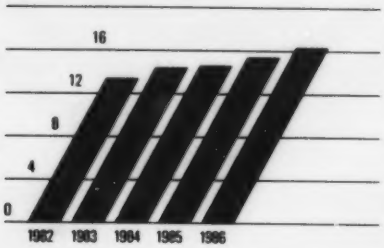
Terri Proehl, production [illegible] at the Utikuma oilfield, managed a productivity improvement program which cut operating costs 26 per cent while netting a 26 per cent increase in production.



Pumpjacks bring oil to the surface at locations throughout Western Canada. Petro-Canada is one of the country's largest producers of crude oil and natural gas liquids.

John Wasson, Brazeau area superintendent, managed the expanded Brazeau natural gas processing plant during its first full year of operations.

Crude oil and field natural gas liquids production, net before royalties (thousands of cubic metres per day)



resulted in a 30 per cent increase in crude oil production volumes while operating costs were reduced 26 per cent from 1985 levels.

During 1986, the Resources Division took advantage of opportunities to make supplemental oil sales and thereby enhance production revenues. The supplemental oil sales program allows producers to sell, outside of regular sales contracts, portions of their production shut in by prorationing. For Petro-Canada, these sales amounted to 5 per cent of total oil production for the year.

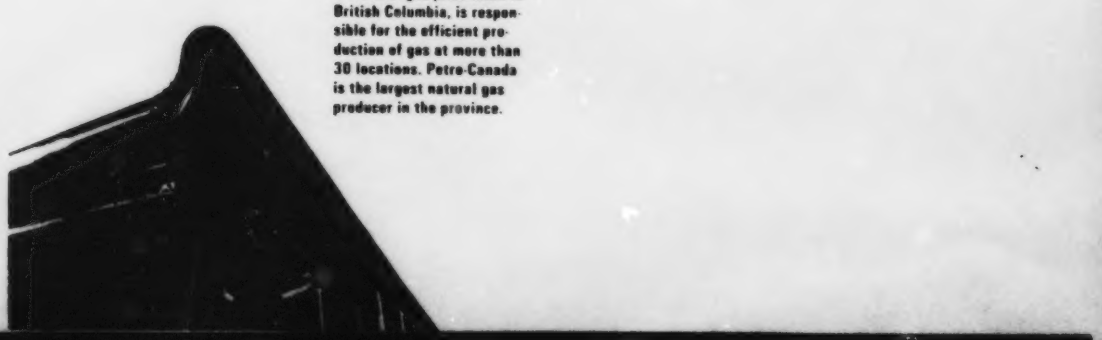
Natural gas marketing emphasized

During the one-year transition period that preceded deregulation of Canada's natural gas industry on November 1, 1986, Petro-Canada intensified its natural gas marketing activities. The Resources Division's gas marketing capability was significantly strengthened in order to compete aggressively in the newly deregulated domestic and export sales markets.

Direct gas sales were sought in British Columbia, where the Corporation holds extensive reserves. On the first day of fully deregulated marketing, contracts were signed with pulp mills in Prince George and Prince Rupert for a total of 480 000 cubic metres a day.

Deregulation has opened a potentially large internal sales market for natural gas, particularly within Alberta. The ability to supply the Corporation's gas to Petro-Canada's own refineries, processing plants and other facilities makes it possible to operate natural gas facilities at higher load factors and to accelerate the connection of proven gas reserves. One natural gas field which the Corporation began to develop in 1986 as a result of this linkage was the Chard field near Fort McMurray, Alberta. Even in a year of depressed market conditions, arrangements

Arnold Henry, a supervisor of natural gas production in British Columbia, is responsible for the efficient production of gas at more than 30 locations. Petro-Canada is the largest natural gas producer in the province.



for internal sales allowed investments to begin for construction of a sweet gas plant and a gathering system to tie in 14 production wells.

Oil sands projects managed effectively

At the Syncrude oil sands mining project near Fort McMurray, Alberta, production during 1986 reached a record level. Petro-Canada's 17 per cent ownership share amounted to 3 500 cubic metres per day of synthetic crude. While near-capacity production helped to minimize the impact of high fixed costs, an expenditure reduction program further cut variable operating costs. Major cost reductions were achieved through delayed overburden removal, extended maintenance schedules and lower levels of corporate and technical support. Capital expenditures were re-examined and the expected completion of the capacity addition project, anticipated to cost a total of $740 million, was delayed by one year to the end of 1988.

During 1986, Syncrude owners and the Alberta Government agreed to conduct engineering work on the feasibility of increasing plant capacity to about 32 000 cubic metres a day.

Petro-Canada maintained its 50 per cent involvement in the partner-operated in situ oil sands project at Wolf Lake, in northeastern Alberta. The Corporation's share of production averaged over 550 cubic metres per day of bitumen by year end. In mid-1986, Petro-Canada and its partner initiated work on expanding the project's capacity to 1 300 cubic metres a day. This $23 million expenditure will serve to optimize the performance of the existing Wolf Lake project.

Discussions are underway with the Corporation's partner and governments regarding possible further expansion of the Wolf Lake project to a total capacity of 3 300 cubic metres per day.

Exploration refocused on Western Canada

With the sharp decline in crude oil prices, Petro-Canada's exploration activity emphasized lower-cost supply sources in the Western Sedimentary Basin.

During the year, significant oil and gas reserves were added to the Corporation's proven reserves base. Most notable were the Sousa and Shekilie discoveries in northwestern Alberta. These and other oil and gas discoveries resulted in accelerated follow-up drilling.

The Corporation's 11-year exploration program off Canada's East Coast entered a transition phase during 1986. Several delineation wells, such as the en-

Derek Lee and Dave Wilson manage exploration efforts within the Western Canada exploration group. During 1986, Petro Canada refocused its exploration on Western Canada.

Bill Fleming, operations superintendent, and Dwayne Zeller, process supervisor, maintain excellent plant performance and reliability at the Empress facility. The natural gas liquids straddle plant, 92 per cent owned by Petro-Canada, is the country's largest.

couraging Terra Nova I-97 and Cohasset A-52, provided a more complete assessment of earlier discoveries. Petro-Canada is continuing its evaluation of discovered fields and its active role in the delineation of the best development opportunities.

Petro-Canada also conducted a modest international program. Exploration in Colombia, Ecuador, Indonesia and Papua New Guinea is aimed at finding significant reserves of low-cost light crude oil to add to the Corporation's asset base.

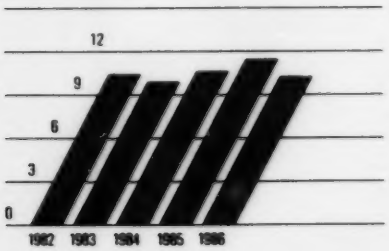
Selective involvement maintained in the most attractive major projects

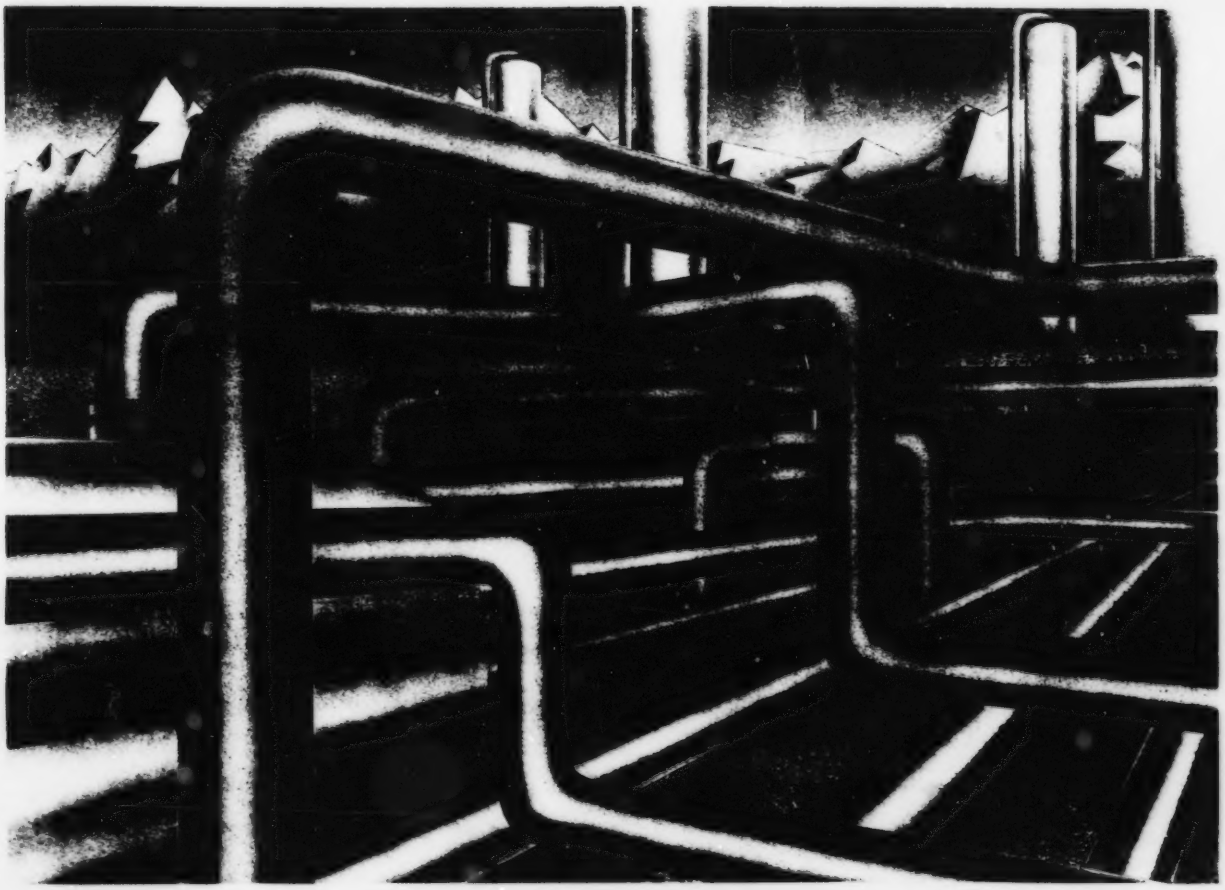
At year-end 1986, there were no plans to proceed immediately with any major development projects. However, Petro-Canada maintained its interest in the more promising of Canada's frontier and oil sands development opportunities. During the year, the Corporation continued to work with partners and the federal and provincial governments to ensure that opportunities are advanced with appropriate timing and adequate assurance of economic success.

In April, the Canada/Newfoundland Offshore Resources Board approved, with a number of terms and conditions, the Hibernia Development Plan. Negotiations were underway at year end between the Hibernia partners and the federal and provincial governments on fiscal arrangements, taking into account the exceptionally large front-end capital investment, the long lead-time before first revenues, and low crude oil price projections.

Overall, Petro-Canada has a stronger oil and gas position off Canada's East Coast than any other company, providing an excellent base on which to build long-term profitability.

Natural gas production, net before royalties (millions of cubic metres per day)





Natural gas is prepared for pipeline shipment at processing plants in Western Canada. Deregulation will open up new markets for Petro-Canada's natural gas.

Products Division Highlights

During 1986, Petro-Canada took advantage of the many opportunities afforded by the September 1985 acquisition of refining and marketing assets from Gulf Canada Limited. Above all, the Corporation took careful stock of its consolidated assets and competitive position, and proceeded to formulate a new set of objectives and strategies for its Products Division.

Integration of supply, refining, research and development, wholesale marketing and retailing, as well as business systems, was largely completed by the end of 1986. An across-the-board restructuring was accompanied in some instances by the relocation of functions, such as the transfer of some 250 executive and professional positions from Toronto to Calgary. From this work, Petro-Canada's Products Division has emerged as an efficient new entity and a significant force in the nation's petroleum refining and marketing industry.

Products Division operating results reflected the Corporation's strong presence in every aspect of the business. Crude oil processed by Petro-Canada's refineries averaged 47 200 cubic metres per day in 1986, with refinery utilization of 72 per cent. Sales of refined petroleum products over the year were 44 300 cubic metres per day. The number of marketing outlets was reduced by 6 per cent to 4 344.

Consistent with the Corporation's expectations, Petro-Canada's sales volumes declined slightly after the Gulf acquisition. Marketing programs continued to be focused on products and markets where the company can take advantage of its product quality, operating capability and market representation to improve its return on investment.

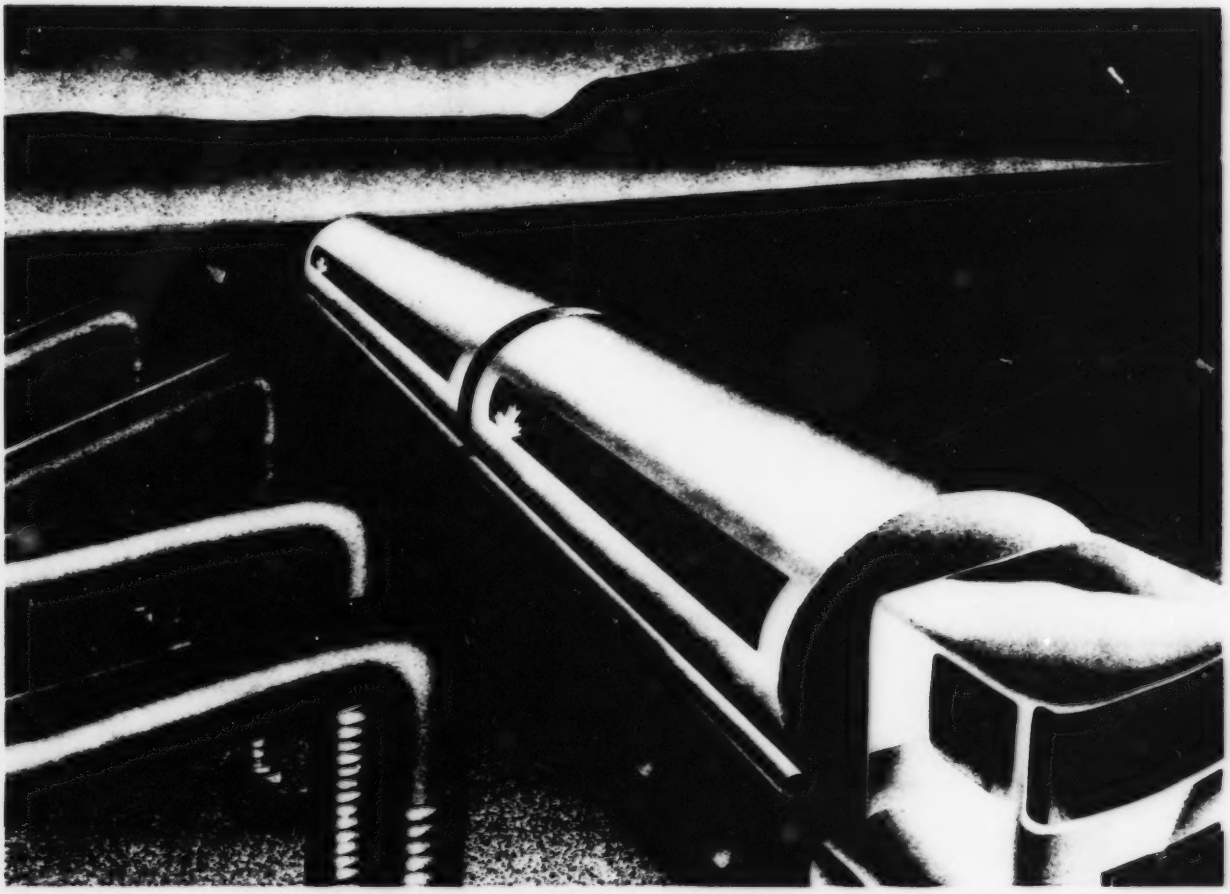
Downstream earnings of $115 million in 1986 represented a significant gain over 1985. Primarily a reflection of improved margins during the second half of the year, these earnings led to a return on average capital employed of 4.0 per cent for the Products Division. Despite this improvement, returns in the refining and marketing business remain below acceptable levels.

Financial and operating profile

Financial	1986	1985
Revenue (millions of dollars)	4 588	4 350
Earnings (millions of dollars)	115	(22)
Average capital employed (millions of dollars)	2 846	2 580
Return on average capital employed (per cent)	4.0	(0.9)
Capital expenditures (millions of dollars)	118	168
Acquisitions including minority interests (millions of dollars)	301	1010

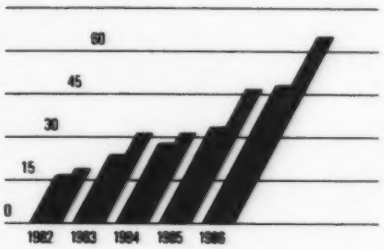
Operating	1986	1985
Crude oil processed by Petro-Canada (thousands of m^3 per day)	47.2	34.2
Refinery capacity (thousands of m^3 per day)	65.5	46.2
Petroleum product sales (thousands of m^3 per day)	44.3	35.5
Number of retail and wholesale outlets	4 344	4 620

As senior director of planning for the Products Division, Dee Parkinson develops strategic plans for Petro-Canada's downstream business.



Refined petroleum products are stored at distribution terminals across the country and then shipped by truck to wholesale and retail outlets. Petro-Canada is the nation's number two marketer of petroleum products.

Refinery capacity and crude oil processed (thousands of cubic metres per day)



Crude oil processed
Refinery capacity

Modern, efficient Edmonton refinery purchased

A significant event for Petro-Canada was the purchase, on April 1, 1986, of the former Gulf Canada Limited refinery at Edmonton. Totally rebuilt in 1971, the refinery was expanded in 1982 to include a dedicated processing capability for synthetic crude oil – the first of its kind in Canada. The facility can handle up to 19 300 cubic metres a day of crude oil, including approximately 6 600 cubic metres a day of synthetic crude transported by pipeline from the Syncrude oil sands plant. The Edmonton refinery produces mostly gasolines, aviation fuels, solvents, diesels and by-products such as propane, butane and coke. These products are transported by road, pipeline and rail to destinations across Western Canada.

The Edmonton refinery is recognized as one of the most modern and efficient in the country. Key reasons for this are its excellent feedstock and product yield flexibility, and its capacity to produce a high ratio of light oil products. The refinery is also close to a variety of crude oil supply sources which limits the need for tankage and on-site inventories. The Corporation is achieving further efficiencies at the refinery through installation of state-of-the-art computerized controls.

Marketing facilities and business practices streamlined

Competition in the marketplace and customer expectations for low prices force a continual search for further efficiencies in both business practices and facilities. This effort has been a driving force in managing the integration of the former Gulf and Petro-Canada networks.

At year end, a major facility and systems rationalization program was nearing completion. Several product distribution terminals were closed, yielding a reduction in fixed costs and inventory requirements.

On Vancouver Island, Petro-Canada closed its Victoria distribution terminal and rebuilt and upgraded its facility in Nanaimo. Gasoline and distillates are now transported by barge from Petro-Canada's Port Moody refinery and

Among the responsibilities of marketing vice-president Ford Ralph was the ongoing program to reidentify retail gasoline outlets.

Jim Murphy, Edmonton Refinery manager, oversees one of the most technologically sophisticated refining operations in Canada.

distributed by truck from the Nanaimo terminal to sales locations across Vancouver Island.

Programs are also well underway to standardize the accounting, credit and distribution practices being used by marketing outlets across the country. An example is the Corporation's light oils distribution system which provides automated inventory control and improved delivery scheduling to retail outlets.

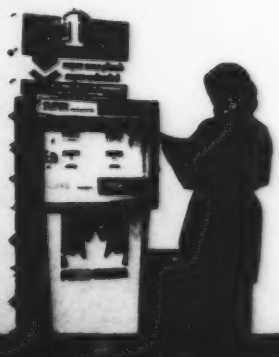
New, high-quality products emphasized

Petro-Canada decided early in 1986 to target its product development work on markets where higher standards of performance are required. In May, the Corporation became the first to introduce a gasoline that was substantially different from that of its competitors. The proprietary product, called "The New 1", is a super unleaded gasoline formulated in response to growing consumer demand for premium-grade gasolines. "The New 1" cleans both carburetor and fuel-injection systems and achieves superior engine performance and reduced maintenance costs – product characteristics increasingly sought by motorists concerned about extending the useful life of their vehicles or ensuring that new high-performance engines function the way they were designed.

Later in the year, Petro-Canada began to extend these benefits to other gasolines, with special deposit control additives being blended in "Unleaded Plus" and "Regular Plus".

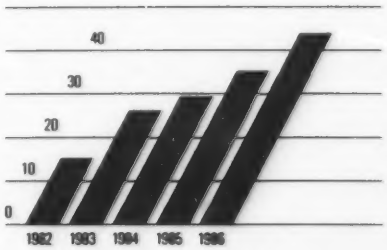
Towards year end, following extensive research at the Corporation's Sheridan Park facility, Petro-Canada introduced a new top-of-the-line lubricant called "Premium Turbo Tested" motor oil. Development of this product involved taking a very stable, specially segregated base stock from the Clarkson refinery's HydroTreating (HT) process and blending it with the latest in motor oil additives. "Premium Turbo Tested" motor oil is made to withstand the extremely hot temperatures and high loads generated by today's turbo-charged and smaller, high-revolution engines. After rigorous testing at Sheridan Park, "Premium Turbo Tested" motor oil was sent to Europe for further evaluation. In West Germany, the lubricant was subjected to the demanding Kombi Engine Test and officially approved for use in all Mercedes-Benz gasoline and diesel passenger car engines.

New products have also been launched by Petro-Canada for commercial and industrial consumers. An example was the introduction in late 1986 of



Suzette Renaud, a marketing representative in Petro-Canada's eastern region, works to ensure that retail outlets provide the quality of service that consumers demand.

Petroleum product sales
(thousands of cubic metres per day)



Gasoline
Distillates
Other

Leslie Lynch, a customer relations manager in Petro-Canada's central region, works with retailers and customers to provide the best possible service.

"Super Compressor Oil". Manufactured from HT base oil and a unique patented blend of anti-oxidant additives developed by Petro-Canada, "Super Compressor Oil" dramatically increases the length of time between servicing of compressor units.

Advanced marketing system successfully tested

By year-end 1986, automated on-line sales data and credit authorization equipment had been installed and tested at several pilot service stations. Successful results led to the decision to begin installing this point-of-sale equipment throughout the Corporation's retail network, beginning in early 1987. Savings are expected in credit administration costs and working capital reductions.

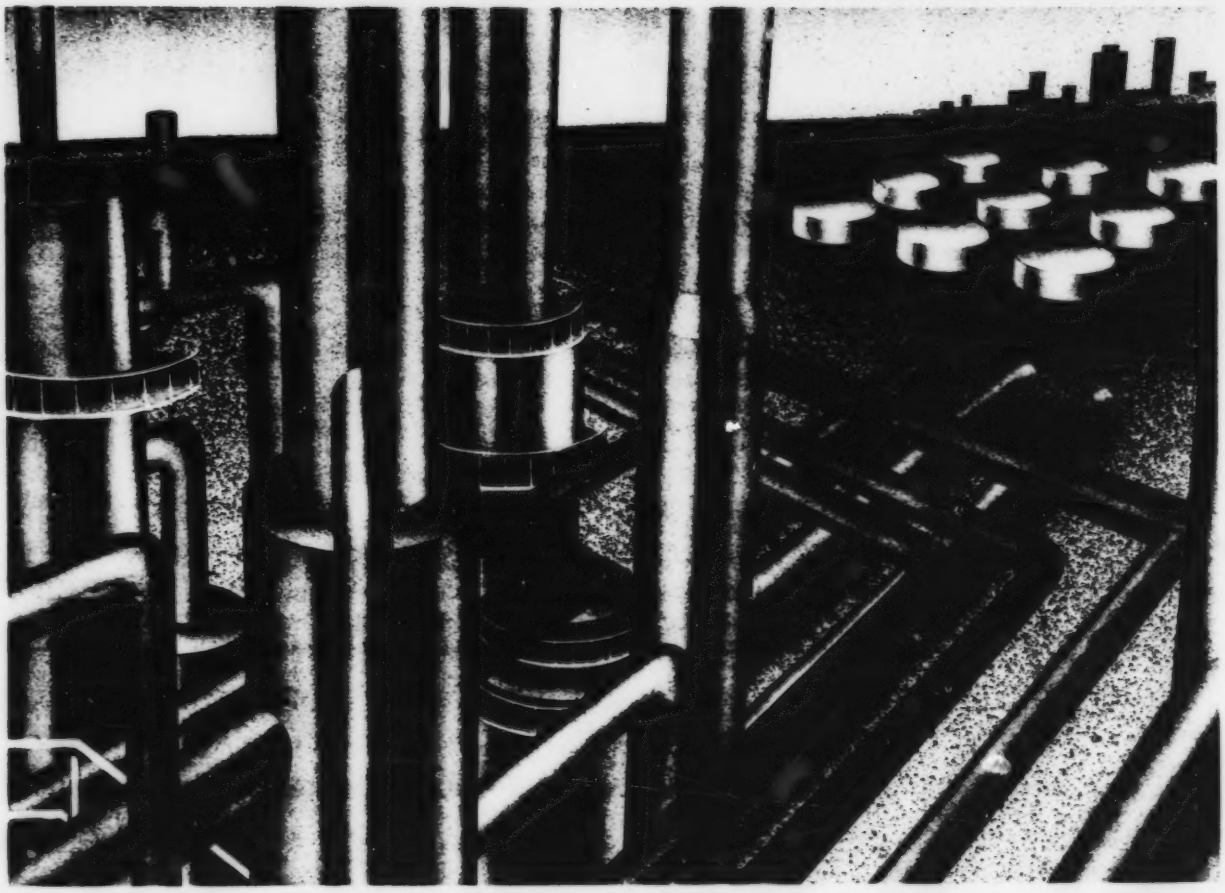
Other advanced marketing systems, including island card terminals, are being piloted at selected retail outlets. Further developmental work will proceed on the basis of consumer reaction and evidence of potential business efficiencies. The Corporation is also actively pursuing automation initiatives in wholesale markets.

Barrie Taylor, director of lubricants, displays one of the motor oils that maintains Petro-Canada's reputation as a manufacturer and marketer of first-quality products.

Renewed energy directed towards customer service

The Corporation's Products Division is now able to offer further improvements in customer service. Canadians have access to a complete range of Petro-Canada manufactured products through an extensive network of service stations and wholesale outlets in every region of the country. The Corporation converted to the Petro-Canada brand about one third of the former Gulf outlets during 1986, concentrating on higher-volume facilities. Much of the remaining reidentification will be completed by the end of 1987.

In addition to offering a range of new, high-quality products, Petro-Canada has set its sights on providing the best customer service in the industry. During the second half of 1986, the Corporation introduced new standards for customer service at retail and wholesale outlets in each region. These standards are being communicated throughout the network by means of a multi-faceted customer relations and training program. Successful, consistent attainment of these standards is encouraged by incentives such as the Club Excellence and Petro-Pride programs.



Petro-Canada is the nation's second largest refiner of crude oil, operating facilities at seven locations and producing a complete line of products.

Corporate Responsibility

As Canada's national oil company, Petro-Canada pays extra attention to operating in ways that benefit Canadians. For many years this has meant, where possible, buying from Canadian suppliers to promote the growth of domestic businesses and employment. In areas where Petro-Canada has production and processing facilities, the Corporation has consistently supported community events. More recently, the Corporation's larger marketing network has provided new opportunities for Petro-Canada to touch the lives of Canadians.

For example, dealers and agents are encouraged to become involved in the communities in which they do business, with such programs as women's car care clinics, children's bicycle safety and youth sports. Retail gasoline promotions are directly linked to support for worthwhile Canadian initiatives, such as restoration of the Bluenose II, backing for promising Canadian Olympic athletes, and building hostels for visiting parents at children's hospitals.

Petro-Canada's donations program is balanced among all regions of the country, focusing on arts and cultural events, education, and such community-based organizations as United Way/Centraide.

The Corporation pays special attention to environmental protection. In both upstream and downstream operations, environmental audits bring potential problems to the attention of management, thereby ensuring that activities are carried out in a responsible manner. To support the federal government's promotion of a more lead-free environment, Petro-Canada has reduced lead levels in its gasoline, and has actively participated in the campaign against misfueling initiated by the Petroleum Association for Conservation of the Environment and the Federal Department of the Environment.

Petro-Canada's most exciting current initiative in the area of community involvement is its sponsorship of the 1988 Olympic Torch Relay. The Corporation undertook this enormous, 88-day project because it was an opportunity to invite all Canadians to share in the Olympic experience. The flame will be carried from St. John's, Newfoundland, along an 18 000 kilometre route through all provincial capitals, major population centres and regions of the country. Every Canadian will be given a chance to participate. As the Games open on February 13, 1988, Petro-Canada will have helped Canadians show the world the diversity and spirit of their country. A legacy of involvement with the Olympics will be left with thousands of Canadians, in hundreds of communities across Canada.

Stephanie Vaness of Montrose, B.C. carrying the torch with Petro-Canada escort runner Patti Barron during a three-day rehearsal for the Olympic Torch Relay. Petro-Canada is the sponsor and organizer of the cross-Canada relay that opens the 1988 Winter Olympics.

Petro-Canada

Management's Responsibility for the Financial Statements

The financial statements have been prepared by management in accordance with generally accepted accounting principles appropriate in the circumstances. Management is responsible for the other information in the Annual Report, which is consistent, where applicable, with that contained in the financial statements. Management is also responsible for installing and maintaining a system of internal control to provide reasonable assurance that reliable financial information is produced. The Corporation has an internal audit department whose functions include reviewing the system of internal control to ensure that it is adequate and functioning properly.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board exercises its responsibilities through the Audit Committee of the Board, a majority of which is composed of directors who are not employees of the Corporation. The committee meets with management, the internal auditors and the external auditors to satisfy itself that responsibilities are properly discharged and to review the financial statements.

The external auditors conduct an independent examination, in accordance with generally accepted auditing standards, and express their opinion on the financial statements. Their examination includes a review and evaluation of the Corporation's system of internal control and appropriate tests and procedures to provide reasonable assurance that the financial statements are presented fairly. The external auditors have full and free access to the Audit Committee of the Board.

Auditors' Report

To the Honourable Marcel Masse, P.C., M.P.
Minister
Energy, Mines and Resources Canada
House of Commons
Ottawa, Ontario

We have examined the consolidated balance sheet of Petro-Canada (incorporated by Special Act of the Parliament of Canada) as at December 31, 1986 and the related consolidated statements of earnings, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Corporation as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied, except for the change (with which we concur) in full cost accounting as explained in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

We further report that, in our opinion, the transactions of the Corporation and its consolidated wholly owned subsidiaries that have come to our notice in the course of our examination of the consolidated financial statements of Petro-Canada were, in all significant respects, in accordance with the Financial Administration Act and the regulations thereto, the charter and by-laws of the Corporation and its consolidated wholly owned subsidiaries and any directives given to the Corporation.

Arthur Andersen & Co

Chartered Accountants

Calgary, Alberta
February 17, 1987

Petro-Canada

Consolidated Balance Sheet

As at December 31, 1986

(stated in millions of dollars)

Assets	1986	1985
Current Assets		
Accounts receivable	$ 874	$ 1 307
Inventories (Note 4)	553	1 110
Income taxes recoverable	20	10
Deposits and prepaid expenses	35	33
	1 482	2 460
Investments (Note 5)	356	291
Property, Plant and Equipment, net (Note 6)	6 223	6 030
Deferred Charges (Note 7)	78	65
	$ 8 139	$ 8 846

Approved on behalf of the Board

Director

Director

Liabilities and Shareholder's Equity	1986	1985
Current Liabilities		
Outstanding cheques less cash	$ 88	$ 22
Accounts payable and accrued liabilities	933	1 489
Current portion of long-term debt	13	20
Short-term notes payable	—	532
	1 034	2 063
Long-term Liabilities	69	198
Long-term Debt (Note 8)	805	269
Advances on Future Natural Gas Deliveries	129	146
Deferred Income Taxes	1 469	1 304
Redeemable Preferred Shares (Note 9)	922	1 224
Capital (Note 10)	4 161	4 161
Deficit	(450)	(519)
	3 711	3 642
	$ 8 139	$ 8 846

Petro-Canada

Consolidated Statement of Earnings

For the Year Ended December 31, 1986

(stated in millions of dollars)

	1986	1985
Revenue		
Operating	$ 5 089	$ 5 300
Investment and other income	83	81
	5 172	5 381
Expenses		
Crude oil and product purchases	2 405	2 901
Marketing, general and administrative	787	552
Producing and refining	576	553
Taxes other than income taxes (Note 11)	512	428
Depreciation, depletion and amortization	394	410
Interest on long-term debt	36	24
Other interest	31	—
	4 741	4 868
Earnings before Undernoted Items	431	513
Provision for Income Taxes (Note 12)		
Deferred	165	296
Current	84	45
	249	341
	182	172
Minority Interest	—	2
Earnings before Unusual Items and Dividends on Redeemable Preferred Shares	182	174
Unusual Items (Note 13)	—	(865)
Net Earnings (Loss) before Dividends on Redeemable Preferred Shares	182	(691)
Dividends on Redeemable Preferred Shares (Note 9)	59	78
Net Earnings (Loss) after Dividends on Redeemable Preferred Shares	$ 123	$ (769)

Petro-Canada

Consolidated Statement of Retained Earnings

For the Year Ended December 31, 1986

(stated in millions of dollars)

	1986	1985
Retained Earnings (Deficit) at Beginning of Year	**$ (519)**	**$ 255**
Net earnings (loss) before dividends on redeemable preferred shares	182	(691)
Dividends – Redeemable preferred shares	(59)	(78)
– Common shares	—	(50)
Exchange adjustment on redemption of redeemable preferred shares	(54)	(17)
Transfer from contributed surplus	—	62
Retained Earnings (Deficit) at End of Year	**$ (450)**	**$ (519)**

Petro-Canada

Consolidated Statement of Changes in Financial Position

For the Year Ended December 31, 1986

(stated in millions of dollars)

	1986	1985
Internally Generated Cash		
Working capital provided from operations (Note 14)	$ 728	$ 870
Proceeds from sale of property, plant and equipment	59	64
Advances on future natural gas deliveries	(17)	(28)
Internally generated cash from operations	770	906
Decrease in operating working capital (Note 15)	406	16
	1 176	922
Investment Activities		
Acquisition of Gulf Canada Limited assets (Note 3)	301	714
Expenditures on property, plant and equipment	814	1 059
Petroleum Incentive Program grants	(168)	(349)
Increase in deferred charges	24	4
Increase (decrease) in investments, net	57	(330)
Decrease in minority interest in subsidiaries	—	296
	830	1 394
Financing Activities and Dividends		
Proceeds from issue of long-term debt	558	165
Increase (decrease) in short-term notes payable, net	(532)	532
Redemption of redeemable preferred shares	(356)	(105)
Dividends – Redeemable preferred shares	(59)	(78)
– Common shares	—	(50)
Reduction of long-term debt	(21)	(47)
	(412)	417
Decrease in Cash	(66)	(55)
Cash (Deficiency) at Beginning of Year	(22)	33
Cash (Deficiency) at End of Year	$ (88)	$ (22)

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 1: Summary of Significant Accounting Policies

(a) Basis of Consolidation

The consolidated financial statements include the accounts of Petro-Canada, an agent of Her Majesty in right of Canada, and of all subsidiary companies ("the Corporation") except Canertech Inc., which is excluded for the reason described in Note 5.

The excess of the consideration paid for the shares of subsidiaries over the underlying net book values at the dates of acquisition is attributed to the related assets acquired and is amortized over the life of these assets.

(b) Inventories

Inventories are stated at the lower of cost and net realizable value.

(c) Investments

The Corporation accounts for investments in companies over which it has significant influence on the equity method. Other long-term investments are accounted for on the cost method.

(d) Property, Plant and Equipment

The Corporation accounts for its investment in oil and gas properties on the full cost method whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized. Such costs include those related to lease acquisitions, geological and geophysical activities, lease rentals on non-producing properties, drilling both productive and non-productive wells and overhead related to exploration and development. Separate cost centres have been established for each country in which the Corporation has an interest in oil and gas properties. The Corporation applies a "ceiling test", to each of its producing oil and gas cost centres, to ensure that such costs do not exceed the estimated future net revenues from production of proven reserves, at prices and operating costs in effect at the balance sheet date, together with the unimpaired costs of certain projects in Canadian frontier areas and of unevaluated properties. In addition a consolidated ceiling test provides for future administrative overhead, financing costs and income taxes.

Costs are accumulated separately for the Syncrude Project, producing in situ and other oil sands leases. Overburden removal costs relating to oil sands which will be mined in future years are deferred and are charged to earnings when the related oil sands are mined.

Substantially all of the Corporation's exploration and production activities are conducted jointly with others. Only the Corporation's proportionate interest in such activities is reflected in the financial statements.

The interest cost of debt attributable to the construction of major new facilities is capitalized during the construction period.

(e) Depreciation, Depletion and Amortization

Costs incurred in producing oil and gas cost centres, other than unimpaired costs of certain projects in Canadian frontier areas and of unevaluated properties, and costs incurred on the Syncrude Project and producing in situ oil sands leases are depreciated or depleted separately on the unit of production method based on estimated proven recoverable oil and gas reserves before royalties. For purposes of calculating depreciation and depletion, natural gas production and reserves are converted to equivalent units of crude oil based on the relative energy content of each commodity.

Costs incurred in non-producing oil and gas cost centres and other oil sands leases are subject to review for impairment. Any impairment is charged to earnings. When exploration proves to be successful, and economic viability has been established, the unimpaired balance is depleted on the unit of production method when production commences.

Depreciation of other plant and equipment is provided on either the unit of production method or the straight line method as appropriate. Straight line depreciation rates are based on the estimated service life of the related asset.

(f) Income Taxes

The Corporation makes full provision for income taxes deferred as the result of claiming depreciation, exploration, development and other costs for income tax purposes which differ from the related amounts charged to expense.

(g) Translation of Foreign Currency

Current assets, except inventories and prepaid expenses, current liabilities and long-term debt are translated at rates of exchange in effect at the balance sheet date. Long-term assets, inventories, prepaid expenses, deferred income taxes and redeemable preferred shares are translated at rates of exchange in effect at the respective transaction dates. Revenue and expense items are translated at the average rates of exchange in effect during the year, except for depreciation, depletion and amortization, which reflect rates of exchange in effect when the assets were acquired.

The resulting exchange gains or losses are included in earnings, except for unrealized exchange gains or losses arising on translation of long-term debt, which are deferred and amortized over the remaining term of the debt.

Foreign operations are integrated with the Corporation's other activities and are translated in the above-described manner.

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 1: Summary of Significant Accounting Policies (continued)

(h) Pension Plans
Costs of pension benefits for current services of employees are funded and are charged to earnings as they accrue. Costs arising from amendments to pension plans which relate to services of employees in prior years and experience deficiencies are funded in accordance with applicable pension legislation and charged to earnings over periods not exceeding fifteen years.

Note 2: Full Cost Accounting

Effective January 1, 1986 the Corporation modified prospectively its full cost accounting for oil and gas properties in accordance with the Canadian Institute of Chartered Accountants' Accounting Guideline "Full Cost Accounting in the Oil and Gas Industry" (Note 1 (d) and (e)). The effect of this change has been to increase 1986 earnings before unusual items and dividends on redeemable preferred shares by $17 million.

Note 3: Acquisition of Gulf Canada Limited Assets

Pursuant to a 1985 agreement, the Corporation agreed to acquire certain refining and marketing assets from Gulf Canada Limited. In 1985, assets were acquired for $714 million and, effective April 1, 1986, the remaining assets, consisting mainly of the Edmonton refinery, were acquired for a further $301 million.

The net assets acquired in 1986, at attributed values, consist of:

Property, plant and equipment	$ 291
Investments	1
Net working capital	9
	$ 301

Note 4: Inventories

	1986	1985
Crude oil, refined products and merchandise	$ 498	$ 1 044
Materials and supplies	55	66
	$ 553	$ 1 110

Note 5: Investments

	1986	1985
At equity		
Westcoast Transmission Company Limited	$ 177	$ 181
Petro-Canada Centre	84	24
Sedpex Inc.	31	23
Other	17	12
At cost		
Mortgages and other investments	47	51
	$ 356	$ 291

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 5: Investments (continued)

Westcoast Transmission Company Limited ("Westcoast")
At December 31, 1986, the Corporation held 30.8% of the outstanding common shares of Westcoast.

Westcoast is a regulated utility and is subject to regulatory directives which may change the components of the cost of service. Changes resulting from such directives do not have a direct effect on net earnings due to rate of return on rate base considerations which are also taken into account in the regulatory process.

At December 31, 1986, the quoted market value of the Corporation's investment in Westcoast was $165 million (1985 – $228 million).

Petro-Canada Centre
At December 31, 1986, the Corporation held 50% of a joint venture which owns Petro-Canada Centre, an office complex in Calgary. The Corporation has entered into a long-term lease for use of a portion of the complex and has guaranteed $232 million of long-term debt related to the facility.

Sedpex Inc.
At December 31, 1986, the Corporation held 50% of the outstanding common shares of Sedpex Inc., a company which owns a semi-submersible drilling vessel. This vessel is under lease to the Corporation.

Canertech Inc. ("Canertech")
The accounts of Canertech, a wholly owned subsidiary company, have been excluded from consolidation because a formal plan exists to dispose of the investment in the subsidiary. In response to a directive by the Government of Canada, the Corporation incorporated Canertech in 1981 to develop alternate energy sources. At that time the Government indicated its intention of purchasing the Corporation's investment at cost and establishing Canertech as an independent crown corporation. During 1984 the Government directed the Corporation to bring about the dissolution of Canertech. The Corporation is proceeding with the implementation of this directive. The Corporation's investment in Canertech is carried in the accounts at its original cost of one dollar.

Note 6: Property, Plant and Equipment

	1986			1985
	Cost*	Accumulated Depreciation, Depletion and Amortization	Net	Net
Natural resources				
Oil and gas				
Canada	$ 5 045	$ 1 788	$ 3 257	$ 3 307
Foreign				
– producing	64	39	25	34
– non-producing	99	80	19	22
Oil sands				
Syncrude Project	667	113	554	526
Producing in situ	99	8	91	80
Other oil sands	203	203	—	—
Natural gas liquids	204	69	135	143
Other	108	79	29	38
	6 489	2 379	4 110	4 150
Refined oil products	2 341	366	1 975	1 737
Other property, plant and equipment	253	115	138	143
	$ 9 083	$ 2 860	$ 6 223	$ 6 030

At December 31, 1986, $3 103 million of Canada oil and gas net costs were subject to depreciation and depletion.

*Cost is net of related Petroleum Incentive Program grants and investment tax credits.

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 7: Deferred Charges

	1986	1985
At cost		
Oil sands overburden removal costs	$ 43	$ 44
Less portion related to oil sands to be mined within one year	11	14
	32	30
At amortized cost		
Deferred financing costs	16	4
Translation adjustment on long-term debt	11	20
Other	19	11
	$ 78	$ 65

Note 8: Long-term Debt

	Maturity	1986	1985
In Canadian dollars			
8.25% unsecured notes	1993	$ 14	$ 14
5.75% unsecured notes		—	7
Other	1987	1	1
In United States dollars			
7.25% unsecured debentures (U.S. $200 million)	1996	276	—
8.25% unsecured debentures (U.S. $200 million)	2016	276	—
LIBOR less 0.8% unsecured notes (U.S. $125 million)	1995	173	175
9% unsecured notes (U.S. $38 million)	1996	52	58
7.75% unsecured notes (U.S. $14 million)	1993	19	19
8.45% unsecured notes (U.S. $5 million)	1987	7	14
Other		—	1
		818	289
Less current portion		13	20
		$ 805	$ 269

Repayment of long-term debt

The minimum repayment of long-term debt in each of the next five years is as follows:

1987 – $13 million
1988 – $ 8 million
1989 – $ 8 million
1990 – $ 8 million
1991 – $ 8 million

Note 9: Redeemable Preferred Shares

The redeemable preferred shares, which were issued by a subsidiary to a group of Canadian chartered banks, are floating rate, cumulative and non-voting. Cumulative dividends, payable quarterly, are, at the option of the subsidiary, based on a percentage of either the United States Base Rates or the London Inter-Bank Offered Rates of the banks. At December 31, 1986, the dividend rate was approximately 3.5% per annum. The shares are redeemable, at the option of the subsidiary, at one hundred dollars U.S. per share, plus accrued dividends. In 1986 the subsidiary exercised its option to redeem 850 000 shares (1985 – 750 000 shares) for a consideration of U.S. $85 million (1985 – U.S. $75 million) and repurchased 1 728 000 shares for a consideration of U.S. $172 million. At December 31, 1986, 7 872 000 shares were outstanding.

Under the terms of an agreement between the banks and the Corporation, in the event that the subsidiary does not exercise its option to redeem the shares over a seven-year period ending December 31, 1993, or in the event of certain other occurrences under the provisions of the agreement, the banks have the option to require the Corporation to purchase the shares at one hundred dollars U.S. per share, plus accrued dividends. These annual options increase from U.S. $78 million to U.S. $139 million over the remaining period.

Note 10: Capital

Authorized

(a) 71 188 common shares with a par value of one hundred thousand dollars each, and
(b) Preferred shares issued to the Government of Canada provided that the amount of such shares together with any loans received, and outstanding, from the Consolidated Revenue Fund of the Government of Canada is not in excess of one billion dollars.

Issued (to the Government of Canada)

	Number of Shares	Consideration
Common Shares		
Balance at beginning and end of year	31 883	$ 3 188
Preferred Shares		
Balance at beginning and end of year	972 771 853	973
Total Capital at End of Year		$ 4 161

The preferred shares have a par value of one dollar each, are redeemable at par at the option of the Corporation, carry no stated rate of dividend and are non-cumulative.

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 11: Taxes Other than Income Taxes

	1986	1985
Federal sales tax	$ 411	$ 249
Petroleum and Gas Revenue Tax	38	124
Other	63	55
	$ 512	$ 428

Note 12: Income Taxes

The provision for income taxes of $249 million (1985 – $341 million) represents an effective rate of 57.8% (1985 – 66.5%) on earnings before income taxes of $431 million (1985 – $513 million). The computation of the provision, which requires adjustment to earnings before income taxes for non-taxable and non-allowable items, is as follows:

	1986	1985
Earnings before income taxes	$ 431	$ 513
Add (deduct)		
Royalties and other payments to provincial governments	169	307
Federal allowances		
Resource allowance	(127)	(260)
Tax depletion	(39)	(21)
Inventory allowance	(5)	(30)
Petroleum and Gas Revenue Tax	38	124
Non-deductible depreciation, depletion and amortization	81	95
Non-taxable gains	(21)	(1)
Equity in earnings of affiliates	(18)	(22)
Other	(3)	3
Earnings as adjusted before income taxes	$ 506	$ 708
Canadian Federal income tax at 47.8% (1985 – 46.9%) applied to earnings as adjusted	$ 242	$ 332
Provincial and other income taxes, net of federal abatement	12	16
Provincial income tax rebates	(5)	(7)
Provision for income taxes	$ 249	$ 341

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 13: Unusual Items

The unusual items charged to earnings in 1985 consisted mainly of asset write-downs associated with Canadian frontier oil and gas properties, process development costs and oil sands properties.

Note 14: Working Capital Provided from Operations

	1986	1985
Earnings before unusual items and dividends on redeemable preferred shares	$ 182	$ 174
Add (deduct):		
Depreciation, depletion and amortization	394	410
Deferred income taxes	165	296
Equity earnings, net of dividends received	—	(7)
Other	(13)	(3)
	$ 728	$ 870

Note 15: Changes in Components of Operating Working Capital

The increase (decrease) in operating working capital consists of:

	1986	1985
Accounts receivable	$ (433)	$ 470
Inventories	(557)	264
Income taxes recoverable	10	(13)
Deposits and prepaid expenses	2	12
Accounts payable and accrued liabilities	556	(681)
Operating working capital acquired from Gulf Canada Limited (Note 3)	(9)	(293)
Accruals relating to 1985 unusual items and other	25	225
	$ (406)	$ (16)

Operating working capital is comprised of working capital other than cash, short-term notes payable and current portion of long-term debt.

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 16: Pension Plans

Based on the most recent actuarial valuations of the Corporation's pension plans, at December 31, 1986 all accrued and vested benefits were fully funded. The actuarial projections of employees' compensation to time of retirement indicate that there was a present value obligation of $36 million (1985 – $67 million) for pension benefits relating to plan amendments and experience deficiencies. This amount is being funded in accordance with the applicable pension legislation.

Note 17: Material Transactions with Related Parties

Transactions with the Government of Canada and its agencies are in the normal course of business and are therefore on the same terms as those accorded to non-related parties.

Note 18: Segmented Information

The Corporation operates in two business segments:

Natural resources, comprising exploration, development, production, transportation and marketing activities for crude oil, natural gas, field liquids, sulphur and oil sands; and extraction of liquids from natural gas.

Refined oil products, comprising purchase and sale of crude oil, refining crude oil into oil products and distribution and marketing of these and other purchased products.

Financial information by business segment is presented in the following table as though each segment were a separate business entity. Inter-segment transfers of products, which are accounted for at market value, are eliminated on consolidation. Corporate and other includes investment income, interest expense and unallocated general corporate revenues and expenditures. Corporate and other assets are principally cash and short-term deposits, investments in other companies and general corporate assets.

Notes to Consolidated Financial Statements

December 31, 1986

(stated in millions of dollars)

Note 18: (continued)

	Natural Resources		Refined Oil Products		Corporate and Other		Consolidated	
	1986	1985	**1986**	1985	**1986**	1985	**1986**	1985
Revenue								
Sales to customers and other revenues	**$ 546**	$ 976	**$ 4 588**	$ 4 350	**$ 38**	$ 55	**$ 5 172**	$ 5 381
Inter-segment sales	**534**	660	**—**	—	**—**	—		
Segment Revenue	**$ 1 080**	$ 1 636	**$ 4 588**	$ 4 350	**$ 38**	$ 55		
Earnings								
Operating earnings before depreciation, depletion and amortization	**$ 470**	$ 888	**$ 385**	$ 51	**$ 57**	$ 10	**$ 892**	$ 949
Depreciation, depletion and amortization	**(245)**	(299)	**(141)**	(107)	**(8)**	(4)	**(394)**	(410)
Interest	**—**	—	**—**	—	**(67)**	(24)	**(67)**	(24)
Provision for income taxes	**(168)**	(392)	**(109)**	34	**28**	17	**(249)**	(341)
Earnings (Loss) before Unusual Items and Dividends on Redeemable Preferred Shares	**$ 57**	$ 197	**$ 115**	$ (22)	**$ 10**	$ (1)	**$ 182**	$ 174
Capital Expenditures								
Capital expenditures on property, plant and equipment*, deferred charges and investments	**$ 319**	$ 520	**$ 118**	$ 168	**$ 92**	$ (172)	**$ 529**	$ 516
Acquisitions including minority interests	**—**	—	**301**	1 010	**—**	—	**301**	1 010
	$ 319	$ 520	**$ 419**	$ 1 178	**$ 92**	$ (172)	**$ 830**	$ 1 526
Total Assets	**$ 4 392**	$ 4 510	**$ 3 222**	$ 3 890	**$ 525**	$ 446	**$ 8 139**	$ 8 846
Capital Employed	**$ 4 102**	$ 4 107	**$ 2 698**	$ 2 995	**$ 305**	$ (319)	**$ 7 105**	$ 6 783

*After deduction of related Petroleum Incentive Program grants and investment tax credits.

Note 19: Comparative Figures

Certain reclassifications have been made to the 1985 comparative figures to conform with the current year's presentation.

Note 20: Commitments and Contingencies

(a) Commitments

The Corporation has leased property and equipment under various long-term operating leases for periods up to 2008. The minimum annual rentals for non-cancellable operating leases are estimated at $55 million in 1987, $51 million in 1988, $48 million in 1989, $42 million in 1990, $37 million in 1991 and $15 million per year thereafter until 2008.

(b) Contingencies

The Corporation is involved in litigation and claims associated with normal operations. Management is of the opinion that any resulting settlements would not materially affect the financial position of the Corporation.

Supplementary Financial Information
Reporting the Effects of Changing Prices (Unaudited)

December 31, 1986

Basis of Presentation

Petro-Canada's financial statements report financial information on the basis of historical cost in accordance with generally accepted accounting principles. Although the rate of inflation declined substantially in recent years, historically the economy has experienced significant inflationary increases and many of the effects of such increases are not reflected in the traditional financial statements. The additional costs required to replace inventories and property, plant and equipment, and the effects of holding net monetary liabilities or assets are not reflected in the historical cost financial statements. The Canadian Institute of Chartered Accountants (CICA) has issued recommendations relating to the preparation of information reporting the effects of changing prices. These recommendations are considered experimental by the CICA.The intent is to determine if this information is helpful to the users of financial information in their assessment of an enterprise. The following information has been prepared based upon the CICA recommendations, except for the computation of the provision for income taxes which is addressed below.

While Petro-Canada has prepared this information using what are considered to be reasonable assumptions, it should be noted that the recommendations call for a degree of subjectivity and materially different results could be obtained if other equally valid assumptions were used. Additionally, the recommendations recognize that the cost of exploration and development required to replace oil and gas reserves is subject to a high degree of uncertainty. Despite this, the recommendations call for the estimating of the current cost of oil and gas reserves and suggest the use of indices. Petro-Canada has followed this approach but cautions that these current cost estimates may be misleading and do not necessarily represent amounts for which the reserves could be bought or costs which would be incurred in future periods if the reserves were replaced.

Explanation of Information

The schedule of Balance Sheet Items on a Current Cost Basis reports the current cost of inventory and property, plant and equipment and the effect of the current cost adjustments on net assets. The current cost of property, plant and equipment has been calculated through the use of indices. Net assets represents the historical common shareholder's equity adjusted for the current cost adjustments.

The Consolidated Statement of Earnings on a Current Cost Basis presents a comparison of the Corporation's statement of earnings as presented in the historical cost financial statements with similar data prepared on a current cost basis. Crude oil and product purchases expense has been adjusted to reflect the current cost of these purchases at the time of use. Depreciation expense has been adjusted so that it reflects the estimated current cost of replacing the operating capacity of property, plant and equipment. The CICA recommends that the amount of income tax in the computation of earnings on the current cost basis be the same as the amount charged against earnings in the historical cost financial statements. However, the Corporation believes that it is more appropriate to adjust the provision for deferred income taxes in recognition of the adjusted cost of sales and depreciation, depletion and amortization expense. Since this unaudited supplementary information is experimental, these adjustments have been reflected in the computation of deferred income taxes in the Consolidated Statement of Earnings on a Current Cost Basis. Had the Corporation followed the CICA recommendations with regard to income tax expense in the computation of current cost earnings, the provision for deferred income taxes would have been $165 million. It should be noted that there is no provision under current tax law for these current cost adjustments.

The schedule of Other Supplementary Current Cost Information presents the remaining financial information required by the recommendations. The financing adjustment represents the portion of current cost adjustments that relate to the net monetary liabilities of Petro-Canada. The CICA has defined this as "the amount of changes during a reporting period in the current cost of assets held by an enterprise that, on the basis of the existing relationship between debt and equity, do not need to be charged against present and future revenues to provide for maintenance of the common shareholders' proportionate interest in the operating capability of the enterprise". The second portion of the schedule isolates the inflation component from the total change in current cost of property, plant and equipment and inventories. The final information presented is the gain in general purchasing power that results from having net monetary liabilities. This arises because inflation erodes the purchasing power of money and therefore where there are net monetary liabilities a "gain" is recognized due to the net monetary liabilities requiring the use of less "purchasing power" over time during inflationary periods.

The CICA recommendations also require the disclosure of oil and gas reserve data, net of royalties. The schedule of Supplementary Reserve Information provides this information.

Balance Sheet Items on a Current Cost Basis

December 31, 1986

(stated in millions of dollars)

	As reported in the historical cost statements	Current cost basis
Inventory	$ 553	$ 585
Property, plant and equipment, net	$ 6 223	$ 8 553
Net assets (shareholder's equity)	$ 3 711	$ 6 073

Consolidated Statement of Earnings on a Current Cost Basis

For the Year Ended December 31, 1986

(stated in millions of dollars)

	As reported in the historical cost statements	Current cost basis
Revenue		
Operating	$ 5 089	$ 5 089
Investment and other income	83	83
	5 172	5 172
Expenses		
Crude oil and product purchases	2 405	2 158
Marketing, general and administrative	787	787
Producing and refining	576	576
Taxes other than income taxes	512	512
Depreciation, depletion and amortization	394	532
Interest on long-term debt	36	36
Other interest	31	31
	4 741	4 632
Earnings before Undernoted Items	431	540
Provision for Income Taxes		
Deferred	165	235
Current	84	84
	249	319
Earnings before Dividends on Redeemable Preferred Shares	$ 182	$ 221

Other Supplementary Cost Information

For the Year Ended December 31, 1986

(stated in millions of dollars)

1) Financing adjustment	
Based on the decrease during the year in the current cost of property, plant and equipment and inventory	$ (13)
Based on the current cost adjustments which increased earnings before income taxes for the year	$ (31)
2) (Decrease) in the current cost of property, plant and equipment and inventory	$ (45)
Effect of general inflation	378
Excess of general inflation over the current cost adjustment	$ 423
3) Gain in general purchasing power from having net monetary liabilities	$ 99

Supplementary Reserve Information

December 31, 1986

	Oil	Natural Gas Liquids	Gas
	(thousands of cubic metres)	*(thousands of cubic metres)*	*(millions of cubic metres)*
Proven reserves, net after royalties at December 31, 1985	34 713.9	5 493.5	77 862.0
Revisions of previous estimates	2 948.6	310.4	1 798.7
Extensions and discoveries	199.4	—	485.8
Production	(3 128.1)	(540.9)	(2 824.0)
Proven reserves, net after royalties at December 31, 1986	34 733.8	5 263.0	77 322.5

The above figures do not include Petro-Canada's 17% interest in the synthetic crude oil reserves of Syncrude Canada Limited ("Syncrude") (37 821.0 thousand cubic metres before royalty at December 31, 1986). Pursuant to an agreement between the Province of Alberta as lessor of the oil sands leases and the Syncrude participants, the Province has the right to 50% of Syncrude's deemed net profits, as defined in the agreement. At the Province's option, this right may be converted to a 7.5% gross production royalty. Both the 50% of deemed net profits and the 7.5% gross production royalty are subject to change under certain circumstances. In view of these options, and the attendant uncertainties relating to future prices and costs, the Corporation has not presented its synthetic crude oil reserves net of royalties.

Five Year Financial Summary

(stated in millions of dollars)

	1986	1985	1984	1983	1982
Summary of Earnings					
Revenue	$ 5 172	$ 5 381	$ 4 988	$ 4 171	$ 2 795
Expenses	4 741	4 868	4 376	3 797	2 440
	431	513	612	374	355
Add (deduct):					
Provision for income taxes	(249)	(341)	(385)	(268)	(230)
Minority interest	—	2	5	6	5
Earnings before unusual and extraordinary items and dividends on redeemable preferred shares	182	174	232	112	130
Unusual items	—	865	—	—	19
Extraordinary items	—	—	—	17	—
Net earnings (loss) before dividends on redeemable preferred shares	182	(691)	232	95	111
Dividends on redeemable preferred shares	59	78	100	86	120
Net earnings (loss) after dividends on redeemable preferred shares	$ 123	$ (769)	$ 132	$ 9	$ (9)
Other Financial Data					
Internally generated cash from operations	$ 770	$ 906	$ 968	$ 708	$ 625
Expenditures on property, plant and equipment	614	1 059	1 131	997	952
Petroleum Incentive Program grants	166	349	380	469	300
Acquisitions including minority interests	301	1 010	(2)	530	345
Total assets	8 139	8 846	8 966	8 194	7 542
Average capital employed	6 944	7 447	7 741	7 080	6 443
Working capital	448	397	905	809	841
Long-term debt (Note 3)	818	289	157	188	331
Redeemable preferred shares	922	1 224	1 312	1 394	1 464
Shareholder's equity	3 711	3 642	4 478	3 932	3 284

Notes:

1. Financial and operating results are included from May 1, 1982, for the operations of Panarctic Oils Ltd., from March 1, 1983, for the former BP Refining and Marketing Canada Limited operations, and from October 1, 1985, for the operations of the assets acquired from Gulf Canada Limited except for the Edmonton refinery, and from April 1, 1986, for the operations of the former Gulf Canada Limited Edmonton refinery.
2. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentation.
3. Long-term debt includes current maturities.

Five Year Operating Summary

	1986	1985	1984	1983	1982
Oil and Gas Landholdings (gross/net)					
(millions of hectares)					
Non-frontier areas					
Conventional	3.7/2.0	4.4/2.1	4.8/2.4	6.0/3.1	6.4/3.3
Oil sands	1.1/0.4	1.0/0.4	0.9/0.3	0.9/0.3	0.8/0.3
	4.8/2.4	5.4/2.5	5.7/2.7	6.9/3.4	7.2/3.6
Frontiers	14.2/8.0	33.2/16.5	41.6/20.5	54.4/25.0	55.7/25.6
International	1.2/0.5	3.4/1.1	2.8/0.4	1.7/0.1	0.6/0.1
Total oil and gas landholdings	20.2/10.9	42.0/20.1	50.1/23.6	63.0/28.5	63.5/29.3
Wells Drilled (gross/net)					
Non-frontier areas – exploratory wells					
Oil	21/13	42/30	65/45	41/30	52/32
Gas	34/15	50/27	25/11	24/16	28/15
Dry	42/24	75/53	74/47	68/48	48/36
	97/52	167/110	164/103	133/94	128/83
Non-frontier areas – development wells					
Oil	283/51	482/169	344/134	148/84	129/68
Gas	32/10	47/26	16/6	17/12	138/86
Oil sands	4/2	0/0	193/96	27/13	0/0
Dry	14/7	48/21	24/10	9/5	49/31
	333/70	577/216	577/246	201/114	316/185
Frontiers and international – exploratory and development wells					
Oil	9/2	16/4	9/2	5/1	7/1
Gas	9/3	10/4	9/2	6/2	3/1
Dry	19/6	26/7	25/8	14/5	7/1
	37/11	52/15	43/12	25/8	17/3
Total wells drilled	467/133	796/341	784/361	359/216	461/271
Proven Reserves					
(net before royalties) (Note 3)					
Natural gas (billions of m^3)	96.7	98.8	120.4	134.3	135.8
Crude oil (millions of m^3)	43.4	45.3	48.4	45.0	47.1
Natural gas liquids (millions of m^3)	7.1	7.4	6.4	7.4	7.7
Synthetic crude oil (millions of m^3)	37.8	39.1	25.4	26.3	27.4
Foreign crude oil (millions of m^3)	0.3	0.5	0.8	0.9	0.9
Total crude oil and natural gas liquids (millions of m^3)	88.6	92.3	81.0	79.6	83.1

	1986	1985	1984	1983	1982
Daily Production (net before royalties)					
Natural gas (millions of m^3)	**10.2**	11.6	10.8	10.0	10.6
Crude oil (thousands of m^3)	**10.3**	10.0	10.3	9.3	9.3
Field natural gas liquids (thousands of m^3)	**2.1**	1.8	1.5	1.5	1.5
Natural gas liquids from straddle plants (thousands of m^3)	**2.6**	2.6	2.6	2.5	2.7
Synthetic crude oil (thousands of m^3)	**3.5**	3.5	2.3	3.0	2.3
Foreign crude oil (thousands of m^3)	**0.4**	0.4	0.4	0.5	0.2
Total crude oil and natural gas liquids (thousands of m^3)	**18.9**	18.3	17.1	16.8	16.0
Refining					
Refinery crude capacity (thousands of m^3 per day)	**65.5**	46.2	31.6	31.6	18.9
Crude oil processed by Petro-Canada (thousands of m^3 per day)	**47.2**	34.2	27.6	25.3	16.6
Refinery utilization (per cent)	**72**	78	86	78	86
Marketing					
Wholesale and retail marketing outlets	**4 344**	4 620	2 716	3 107	1 605
Petroleum product sales (thousands of m^3 per day)					
Gasoline	**20.3**	16.3	13.9	12.9	7.3
Distillates	**16.2**	12.2	9.6	8.7	5.1
Other including petrochemicals	**7.8**	7.0	6.3	5.5	2.9
Total petroleum product sales	**44.3**	35.5	29.8	27.1	15.3
Employees					
Number at year end	**7 740**	9 747	6 798	6 272	5 918

Notes:

1. Certain reclassifications have been made to the figures previously reported to reflect subsequent changes in reporting presentation.
2. Operating results are included from March 1, 1983, for the former BP Refining and Marketing Canada Limited operations, from October 1, 1985, for the operations of the assets acquired from Gulf Canada Limited except for the Edmonton refinery, and from April 1, 1986, for the operations of the former Gulf Canada Limited Edmonton refinery.
3. Proven reserves do not include any reserves associated with frontier discoveries in Northern Canada and the East Coast offshore.

Executive Council members, left to right: David O'Brien, Bill Hopper, Bob Mayo, Ed Lakusta and Jim Stanford.

Board of Directors

†*Wilbert (Bill) H. Hopper
Chairman of the Board
and Chief Executive Officer
Petro-Canada
Calgary, Alberta

†Edward M. Lakusta
President
and Chief Operating Officer
Petro-Canada
Calgary, Alberta

*Robin Abercrombie
Consultant
Roberts Creek Resources Ltd.
West Vancouver, B.C.

Alfred E. Barroll
Consultant
A.E. Barroll Resource
Consultants Ltd.
Calgary, Alberta

†Jean Bazin, Q.C.
Senior Partner
Byers, Casgrain
Barristers and Solicitors
Montreal, Quebec
(resigned January 1987)

Rudolph Bratty, Q.C.
Senior Partner
Bratty and Partners
Barristers and Solicitors
Downsview, Ontario

Roy Victor Deyell, Q.C.
Senior Partner
Parlee McLaws
Barristers and Solicitors
Calgary, Alberta

Anne R. Dubin, Q.C.
Senior Partner
Tory, Tory, DesLauriers
and Binnington
Barristers and Solicitors
Toronto, Ontario

†*William McBurney Elliott, Q.C.
Senior Partner
MacPherson, Leslie and Tyerman
Barristers and Solicitors
Regina, Saskatchewan

*John Lundrigan
Consultant
Lundrigan Consulting Services Ltd.
St. John's, Newfoundland

†H. Harrison McCain
Chairman of the Board
McCain Foods Limited
Florenceville, New Brunswick

*Jocelyne Pelchat
Vice-President – Dailies
Quebecor Inc.
Montreal, Quebec

†David Read
Businessman
McDonald's Restaurants Ltd.
Dartmouth, Nova Scotia

James Robertson
Businessman
Mack Travel Ltd.
Inuvik, N.W.T.

William W. Siebens
Businessman
Candor Investments Ltd.
Calgary, Alberta

*Audit Committee Member
†Executive Committee Member

Senior Officers

Wilbert (Bill) H. Hopper
Chairman of the Board
and Chief Executive Officer

Edward M. Lakusta
President
and Chief Operating Officer

David P. O'Brien
Executive Vice-President

Robert J. Mayo
President
Petro-Canada Products

James M. Stanford
President
Petro-Canada Resources